STUDIES IN INDIAN ECONOMICS

EDITED BY

C. N. VAKIL
UNIVERSITY PROFESSOR OF ECONOMICS, BOMBAY

STUDIES IN INDIAN ECONOMICS

A series of Volumes dealing with the Economic History and problems of Modern India

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UNIVERSITY PROFESSOR OF ECONOMICS, BOMBAY

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FINANCE UNDER PROVINCIAL AUTONOMY

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PREFACE

"Financial Developments in Modern India, 1860-1924" was published by the end of 1924. Since then great changes have taken place in the sphere of finance in this country. The literature on the subject has been growing at such a rate that it is extremely difficult to be up-to-date in information and ideas, unless one is in a position to devote his entire time to the continuous study of this absorbing subject. The importance of the study of this subject has further grown with the advent of Provincial Autonomy in 1937, because the power of the purse has been transferred to a great extent to the representatives of the people in the Provinces. These observations are made with a view to explain, if not to justify the fact that I have not been able to meet the demand of Universities and the public for a second edition of "Financial Developments". A few studies on different aspects of the subject have been published by different authors in the interval, but the need for a comprehensive review of financial events in the country still remains unfulfilled. Any attempt at a thorough study of the financial events and problems of the country must result in a series of volumes, each devoted to a special aspect or period of the problem. A definite beginning towards this end has been made in this School with the help of a few advanced research workers, and it is expected that in due course the results of this work will be published. While these studies must take time it has been thought desirable to publish a brief review of recent events in Provincial Finance in view of their current importance. This small study may therefore be taken as an earnest of the fuller studies now under preparation. In view of this new plan, the original intention to issue a revised and up-to-date edition of "Financial Developments" has been

given up, though a reprint of the same to serve as a historical volume on Indian Finance from 1860-1920, may be issued if there is a demand for the same.

By the time this book was ready in manuscript form, the Report of the Resources and Retrenchment Committee of the Punjab Government was published, and we were happy to find considerable agreement in that report with our views on schemes for fresh sources of revenue in the Provinces. These have been indicated in the footnotes in the relevant places. The Niemeyer Award has been substantially altered recently while the book was still in the press ; note has been taken of the change in Appendix III. In view of the current importance of Sales Tax as an additional source of revenue in the Provinces, we have published the articles on the subject which we contributed to the " Commerce " in February, 1939. The criticism which we then offered on the proposals for a Sales Tax on cloth in the Bombay Presidency has been borne out by subsequent events, and we trust that the experience of other countries which we have briefly reviewed in this Appendix will be of interest to those concerned. We are indebted to the Editor of the " Commerce " for permission to make use of these articles in this book. I am also indebted to the University of Bombay for permission to reprint my article on " State and Economic Life in India " contributed to the Journal of the University of Bombay in July, 1939.

I may add that the greater portion of the material required for this book was collected by Mr. M. H. Patel, Research Assistant in Economics in this School, but for whose willing assistance it would have been difficult to publish this book in time.

C. N. VAKIL.

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31*st March,* 1940.

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CHAPTER I

PROVINCES AS FEDERAL UNITS

Evolution of Provincial Finance

The discussions which began with the appointment of the Simon Commission in 1927 to devise a suitable political constitution for this country ended after various circuitous stages in the Act of 1935. The federal part of the Act met with opposition from all quarters though from different points of view and could not be put into operation. The outbreak of the War gave a convenient opportunity to declare this part formally suspended. The other part of the Act relating to Provincial Autonomy was put into effect from 1st April 1937. A situation unparalleled in the history of democratic states was created at the very outset by the refusal of the majority party in most of the Provinces to take power unless certain things were clarified. The tension was eased by tact on both sides and the Congress party assumed power in the Provinces concerned. Since the outbreak of the War, the Congress Ministries have resigned on the wider issue of the war aims of Great Britain with reference to this country. Provincial Autonomy has been suspended in consequence ; the Governors have assumed power and have appointed advisers to assist them; only in Assam an alternative Ministry could be formed.

This brief reference to the political situation in the country is necessary for a proper grasp of the financial developments in recent years. Finance and politics are closely interrelated, and each acts and reacts on the other. For example, before 1921, the Government of India was responsible to Parliament for the government of this country. The Provinces were merely the agents of the Central Government. In all important matters, policy was laid down at the Centre, for the Provinces to administer. The same applied to finance. British India was one financial unit and the Government of India was responsible for the financial security and the public debt of the country as a whole. This centralised system of finance

which began in 1833, was systematised in 1860. But the difficulties of working such a system in a vast country with a growing population were great. The need for decentralisation was felt. But the Government of India could not divest itself of the burden so long as it was responsible to Parliament for the government of this country. In spite of this, administrative arrangements were devised to make the system elastic by giving some measure of power in finance to the Provincial Governments though under Central control. By the very nature of things such powers could not be given in taxation, because central responsibility would be affected thereby. It was only in the field of expenditure that the Provinces could be given some freedom. For this purpose various financial settlements were made beginning with 1870. These were periodically revised. These settlements were based primarily on the estimated needs of individual provinces and not on their revenues. In other words, the system amounted to this : The revenues of India were raised on lines laid down by the Central Government and were treated as one central fund. For purposes of expenditure, the Provinces were comparatively free, within the terms of a settlement for the time being in force. The Central Government thus obtained some administrative ease in expenditure, while yet retaining its general control as required by Parliament.

Reforms of 1921

With the introduction of the Montagu Reforms of 1921, in the form of Limited Provincial Autonomy, the financial arrangements had also to be changed. The functions of the Central and Provincial Governments were defined, and the revenues of India were also divided into Central and Provincial. A perfect system of division of the revenues of India in this way was not possible. In order that the Central Government might have adequate resources for its responsibility, it was laid down that the Provinces should give certain contributions to the Centre. This proved a source of friction and

had to be soon abandoned. But the main defect of the system remained and made progress impossible. The Provinces were charged with the responsibility of developing nation-building services like education, agriculture, industries, sanitation and so on, but the resources at their disposal were limited and not capable of expansion. The more elastic sources of revenue like Customs and Income Tax were with the Central Government. In other words, provincial prosperity was subordinated to central security.

Financial Settlement of 1935

Having accepted the principle of federation, the framers of the Act of 1935 had to introduce the principles of federal finance in their new scheme. These may be briefly described as (a) independence and responsibility of, and (b) adequacy and elasticity to, all the units of the Federation. The conception of Provincial Autonomy involved financial autonomy. The conception of responsible government in the Provinces involved the right to levy taxes and to incur expenditure according to the desire of the popularly elected assemblies. From this it followed as a corollary that the resources placed at the disposal of the Provinces should not only be adequate for the immediate task of government, but also be capable of expansion to meet the growing needs of the new popular governments. The Peel Committee of the Third Round Table Conference had obviously these considerations in mind when it observed, " that the aim which we have kept in view may be summarised as follows: To provide that all provinces may start with a reasonable chance of balancing their budgets; to afford them the prospect of revenue sufficiently elastic for subsequent development and to ensure the solvency of the Federation."

Under the Act,[1] a clear division of the sources of revenue and expenditure between the Federation and the Provinces

[1] Cf. Sections 136 to 180 and the Federal and Provincial Legislative lists.

has been made. It was however realised that this arrangement would result in deficits for some Provinces, and would mean difficulties for others in course of time. Some adjustments were obviously necessary to make the system workable, and Sir Otto Niemeyer was appointed to go into the question, and his recommendations were accepted.

The financial arrangement as laid down in the Act and in Sir Otto Niemeyer's report may be summarised as under:—

Provincial sources of Revenue

1. Land Revenue.
2. Excise duties on alcoholic liquors, opium, hemp, other narcotic drugs, medicinal and toilet preparations containing alcohol manufactured or produced in the province, and countervailing duties on similar articles manufactured or produced in other parts of India.
3. Taxes on agricultural income.
4. Taxes on lands and buildings.
5. Succession duties in respect of agricultural land.
6. Taxes on mineral rights subject to any limitation imposed by a federal law relating to mineral developments.
7. Capitation taxes.
8. Taxes on professions, trades, callings and employments.
9. Taxes on animals and boats.
10. Taxes on sale of goods and on advertisements.
11. Cesses on entry of goods.
12. Taxes on luxuries including entertainments, amusements, betting and gambling.
13. Stamp duties in respect of documents other than those assigned to the Federal Government for such taxation.
14. Taxes on goods or passengers carried on in inland water-ways.
15. Tolls.
16. Fees in respect of provincial legislative list.

Taxes to be levied and collected by the Centre for the benefit of the Provinces.

In addition to the above sources, there are some sources of taxation which may be levied and collected by the Federation only for the benefit of the Provinces, and distributed in accordance with principles laid down by the Federal Legislature, *viz.* duties in respect of succession to property other than agricultural lands, stamp duties mentioned in the Federal Legislative list,[1] terminal taxes on goods and passengers. Duties on salt, federal excise duties like that on sugar, and export duties shall be levied and collected by the Federation, but if an Act of the Federal Legislature so provides, the whole or a part of the net proceeds are to be distributed among the Provinces in accordance with the principle laid down in the Act.

The justification for this method is the need for uniformity of rates and economy in administration in the case of those taxes. It has however been provided that the federal legislature may levy a surcharge on such taxes for the benefit of federation, if necessary.

Taxes on Income

The principle that the Taxes on Income should be divided between the Centre and the Provinces is accepted in the Act. This does not apply to the tax on corporations, tax on federal emoluments and receipts from centrally administered areas. It need not be mentioned that this applies only to non-agricultural incomes. The tax on agricultural incomes has been entirely provincialised.

But in actual practice, the payment of the necessary amounts was dependent on the solvency of the Centre. We shall refer later to the large slices which the Centre had to give up in order to enable some of the deficit Provinces to make a start.

1 "The rates of stamp duty in respect of bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, proxies and receipts." Item 57.

Besides, due to continued deficits in the Railway Budget, the Railway Contributions to the General Revenues could not be paid. There was no immediate prospect of the Railway finances showing any improvement. The Central Government was committed to certain large expenditure, *e.g.* on Defence, and its financial stability had to be guaranteed in any case.

In the opinion of Sir Otto Niemeyer, the Central Government was likely to strengthen its position in five years and be able to release the share of income tax to the Provinces. It was expected that during this period, Central finances would improve by natural expansion and also by the contribution of the railways. On this ground it was recommended that during the initial prescribed period of five years, the Centre was to retain the whole or part of the share of the Provinces as was necessary to bring the proceeds of the share accruing to the Centre and the Railway Contribution to Rs. 13 crores.[1] After the period of 5 years, the retained portion was to be reduced by 1/6th each year so that in the eleventh year of the autonomy the Provinces would be entitled to the full share of Income Tax.

The next point was to assign their shares to the different units. It was a complicated problem as each province advocated as the basis of division, either population, residence, or origin whichever was most favourable to itself. Sir Otto Niemeyer felt that substantial justice would be done by fixing the scale of distribution partly on residence and partly on population. On this basis he recommended the following percentage scale: Madras 15, Bombay 20, Bengal 20, U.P. 15, the Punjab 8, Bihar 10, C.P. 5, Assam 2, N.W.F.P. 1, Sind 2, Orissa 2.

Defects of the scheme

The Federal Government can levy a surcharge on income tax for its own purpose while the Provinces cannot. The

[1] This was the amount necessary to balance the Central Budget in the beginning.

White Paper proposed that the Provincial Legislature should be empowered to impose a surcharge not exceeding 12½ per cent on the taxes levied on personal incomes of the residents in the province and to retain the proceeds for its own purpose.[1] The Joint Parliamentary Committee which considered these proposals admitted that the proposal would give elasticity to provincial revenues, but rejected it as in their opinion the objections outweighed this advantage. It would lead to differential rates and nullify the power of surcharge of the Federal Government as the rates were already too high.[2] In the U. S. A., the States and the Federation tax concurrently both income tax and inheritance tax. Many States have availed themselves of this and a large amount is raised from this source. The right to levy a surcharge, however limited, would have given an elasticity to the revenues which they lack now.

Another defect of the scheme is that the distribution is made dependent upon the working of railways. Sir Otto Niemeyer laid stress upon the disquieting position of the railways and recommended a thoroughgoing overhaul of Railway expenditure as the solution was important to the whole provincial problem.[3] But there is very little evidence of any serious effort to meet the situation. On the expiry of the moratorium of the debt to the Railway Depreciation Fund by the end of 1939-40, devised to enable the provisional distribution of income tax, there are only two alternatives other than its extension, *viz.* accounting manipulations to reduce depreciation charges, or a financial reorganisation of the railways with a determination to reduce expenditure.

The distribution of income tax as adopted in the Order-in-Council cannot be altered as between the Federation and the Provinces or the Provinces *inter se* on the basis of population

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1 White Paper Proposals para 57.
2 J. P. C. Report para 257.
3 I. F. E. Report p. 12.

or residence. This rigidity has been enforced to avoid subsequent friction.

Special assistance to some Provinces

The next question was about some Provinces where the available sources of revenue were never likely to be sufficient to meet any reasonable standard of expenditure. It was one of the objectives of the Act that each Province should start on an even "keel" on the inauguration of Provincial Autonomy. On examining the financial position it was found that Bombay had received a relief of Rs. 90 lakhs by the separation of Sind; Madras and Bihar Rs. 20 lakhs and Rs. 8 lakhs respectively by the separation of Orissa. The U.P. was only in a temporary difficulty while the standard of expenditure of the Punjab was not low. The other Provinces needed special help. After due investigation, it was concluded that the following assistance would be sufficient to achieve the objective; Bengal Rs. 75 lakhs, Bihar Rs. 25 lakhs, C.P. Rs. 15 lakhs, Assam Rs. 45 lakhs, N.W.F.P. Rs. 100 lakhs, Orissa Rs. 50 lakhs, Sind Rs. 105 lakhs, U.P. Rs. 25 lakhs for 5 years.

Three methods were suggested to achieve this. They were (a) the increase in the share of jute export duties, (b) cancellation of debt and (c) direct subvention. Bengal, Bihar, Assam and Orissa shared in the increase in the percentage of jute export duties, which was now raised to 62½ per cent. from 50 per cent. as originally laid down. Debts contracted with the Centre by Bengal, Bihar, Assam, N.W.F.P. and Orissa prior to 1st April 1936 were wholly cancelled, while in the case of the C.P. only the debt due to deficits was cancelled. Besides the U.P., Assam, N.W.F.P., Orissa and Sind got direct subventions.[1]

[1] U.P. 25 lakhs for a period of 5 years; Assam 30 lakhs with additional 10 lakhs for the Assam Rifles; N.W.F.P. 100 lakhs subject to a revision after a period of 5 years; Orissa 40 lakhs with additional 7 lakhs in the first year and 3 lakhs in the next four. Sind 105 lakhs for the first ten years, with additional 5 lakhs in the first year, 80 lakhs in the next 20 years, 65 lakhs in the next 5 years, 60 lakhs in the next 5 years, and 55 lakhs in the next 5 years.

It may appear at first sight that the Centre was sacrificing large amounts for the benefit of the Provinces. During the Montagu regime it gave up the Provincial Contributions of Rs. 10 crores. The subventions and other financial aids to the Provinces referred to above involved another equal amount. As against this, it must be pointed out that large additions to taxation had been made by the Government of India during 1921-23 and again during 1931-33, and these had come to stay. Besides, the Centre was no longer to be responsible for various functions of government which were now wholly provincial. It must also be remembered that in a Federation, the taxing authorities are many, but the taxpayers are the same. The real question was how best to distribute the spending power of the State between the different units in the common interests of all.

Any such scheme will always be subject to criticism. For example, in the present arrangement, Bombay is at a disadvantage. It is a poor consolation to Bombay to be told that the amount which she was contributing to Sind, will now be saved. She has inherited debts due to unsuccessful ventures like those of the Back Bay Reclamation, and no relief has been granted to her on the Loan Account, with the consequence that on the one hand she has a large annual burden for the interest and sinking fund charges, on the other she finds it difficult to raise new loans for her development programmes. It is Bombay that contributes most to the Income Tax, but she cannot get her due share under present conditions. But in the forward march to political and economic progress, the most advanced unit may have to march with the speed of the most backward in order that all may march together, and in this lies the explanation of the financial arrangements referred to above.

Comparison with other Federations

It will be of some interest at this stage to compare our financial scheme with that adopted in other federal countries.

In India there is a definite enumeration of the sources assigned to the Centre and the units. Each Government is aware of the exact resources at its disposal. In other federations the distribution is by classes. Generally the direct taxes belong to the States and the indirect to the Federation. In the United States of America the indirect taxes belong to the Federation and the direct taxes to the States. The increasing demands on the Federal resources however, necessitated the amendment of the Constitution in 1913, and the income tax was assigned also to the Federation. In the Commonwealth of Australia, the Federal Government has the customs, excise and 60 per cent. of the income tax assigned to it. The States are assigned land tax, 40 per cent., of the income and entertainment tax. In Canada, all indirect taxes at the outset were exclusively federalised, leaving to the States direct taxation. Increased charges owing to the last World War necessitated fresh taxation for the benefit of the Dominion Government. Taxes on corporations, bills and cheques, means of communication, income tax and business taxes were imposed.

This leads us to the conclusion that there is universal and exclusive allocation of customs and excise revenue to the Federal Government. Income tax was first left to the States. But the World War precipitated a great change. It compelled the Federal Government to encroach upon the direct taxation of which income tax was the first. In India there is a material difference. The allocation is by more elaborate enumeration. Excise duties have been distributed between the Centre[1] and the Provinces and what may be called restrictive excise has been provincialised, and income tax federalised subject to a share for the Provinces. Such elaborate allocation of resources marks an advance on the system of federal finance.

Besides this general principle, several methods have been evolved for the allocation of sources between the Centre and

[1] Vide item 2 on page 4.

the units. Prof. Seligman[1] lays down five methods governing the financial relations of federated states. (1) The first is the complete separation of sources of revenue between the Central and the Provincial governments. There are certain sources of revenue utilised entirely by the federal governments and another set exclusively provincialised. This is the best system that can be devised. It is obviously very difficult in practice to get such a complete division of sources. (2) Taxes may be assessed by provincial authorities with surcharges by the federal government. This is the method employed in America in taxing general property, which is first assessed by the local authority and the state levies its tax on that valuation. The fact that the state authorities are utilising the same base has led the local authorities to underassess the property. (3) The tax may be assessed by the Central Government with additions for state purposes. The method of additions is very common in France. But one danger is that the tax rate may run so high as to be oppressive to the taxpayers. It is desirable to lay down the maxima and minima in such cases. (4) The division of the yield of taxes such as the Income Tax and Jute Export duties. In this case there is no possibility of over assessment and there is uniformity in rates and economy and efficiency in administration. (5) The last method of adjustment is a system of subvention from the federal government to the local government.

The financial system of the Indian Federation is a combination of these methods. On the one hand there is the separation of sources. Each unit has definite sources of revenue assigned to it. Next there is the division of certain revenues between the Federation and the Provinces. Definite percentages of the jute export duties and the income tax are to be handed over to the Provinces. Lastly, direct subventions are also given to the smaller Provinces. It is by these methods

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[1] Essays in Taxation. Chapter XXI.

that a balance has been attained in the system. The purpose of taxation is to transfer purchasing power from one person to another. In a federation it is the transfer of purchasing power from one unit to another in the first instance. It has been attained by the methods mentioned above. The principle of independence is thus sacrificed to satisfy the principle of adequacy. But it is more essential that each unit of the federation should have satisfactory resources for its functions, otherwise it will be a drag on the progress of all.

CHAPTER II.

STATE AND ECONOMIC LIFE IN INDIA

Introduction

The financial arrangements of a country are conditioned by several factors, the chief among them being (1) the constitutional position; (2) the conception of the State regarding its function re: the economic life of the people; and (3) the capacity and the needs of the people. We have briefly reviewed the first, and the third will be borne in mind throughout our discussion in the later chapters of this book. We propose to confine ourselves in this Chapter to the second factor. In view of the importance of this factor in determining financial policy, we think it proper to discuss this aspect both from the historical and the comparative points of view. This treatment will enable us to appreciate better the changes that have taken place, the new aspirations which remain to be fulfilled, and the limitations which exist due to our constitutional difficulties, which have been already referred to.

The State in the Nineteenth Century

Before we consider the problem of the State in relation to economic progress as it affects us in this country, it would be better to be clear about the general conception regarding the economic functions of the state in modern times. During the last century there were broadly speaking, two distinct views regarding the economic functions of the state. In England it was believed that the state should not interfere in economic activities, and that it was best to leave the people alone in their efforts to increase production as well as to distribute the same among themselves. Partly because of her early start as an industrial nation, and partly because of her oversea possessions, it was convenient for England to adopt this attitude. In other countries, chiefly in Germany, a different view prevailed to the effect that the State should in a variety of ways help the people to increase production. State assistance to industries

was one of the chief methods by which this view was put into practice. So far as the removal of inequalities in the distribution of wealth was concerned, though socialistic ideas did not prevail fully, steps were taken in some countries, chiefly in Germany, to introduce social legislation with a view to improve the condition of the poorer sections of the people. To some extent these ideas influenced legislation even in conservative countries like England.

The chief reason why most of the countries other than England adopted a policy by which the state was required to take an active part in economic matters was the fact that they found themselves late in the field so far as industrial progress was concerned, and realised that they should organise themselves on national lines, if they were to develop their economic resources and increase their trade. This explains the existence of tariff systems prevailing in different parts of the world and other measures to develop industries and help trade, during the last century.

The State in Modern Times

Since the war the conception of the state in relation to its economic activities has been considerably expanded. In spite of the differences in outlook between the different states in the nineteenth century the people were on the whole left free ; they received state assistance in some way in most countries unlike in England. But nowhere did the state take upon itself the functions of direct control of economic activities. We now find that these ideas have been thoroughly changed. Instead of leaving the people to carry on their economic activities in a free manner, the state prefers to control and guide the economic activities of the people in an organised manner. Whereas the State was concerned essentially with the problems of the security of its subjects in the nineteenth century, it is now concerned also with problems of the prosperity of its subjects. These tendencies have revolutionised the structure and machinery of modern states. There are differences in

degree regarding the extent to which the state intervenes, either in organising production or distribution of resources within its territory. There are differences also in the outlook or the ultimate aim with which such intervention takes place. In Russia the instruments of production are controlled by the state, industries have been nationalised and the national production is distributed among the people with a view to satisfy the needs of the largest possible number as far as possible. In Germany and Italy production is considerably controlled from the centre, though radical efforts at equitable distribution of resources are not made. As against the socialistic economy in Russia we have a kind of state capitalism in Germany and Italy. To carry out both these different types of economic organisation, centralisation is required to such an extent that power has to be entrusted to dictators. In other countries like England and America, we have democratic institutions still surviving, but these have been adapted to new circumstances. The Roosevelt Regime in America has been characterised by the most gigantic state effort in a capitalist economy to introduce measures for general recovery, in almost all spheres of economic activity. To carry out these measures Roosevelt was given extraordinary powers. The National Government in England in recent years has reduced the party system of Government to a formality, and thereby assumed special powers, which has enabled it to introduce promptly thoroughgoing measures of state assistance not only in industries, but also in agriculture, trade and other spheres. The state has thus given up its former attitude of *laissez-faire*, and is now regulating in a variety of ways economic activities in agriculture, industry, trade and transport and also trying to bring about better distribution by spending more on social services from resources obtained by taxing the rich. Whatever the form of government, it is thus obvious that there is an increasing interference by the state in the economic sphere and this tendency has come to be known as planned economy.

Absence of one State in India

In order to be able to study the problem with reference to our country, we have to remember two broad facts, firstly that we do not have one state in the country, and secondly, that the structure and functions of the state or states existing in the country are in the process of evolution and have undergone fundamental changes, particularly in this country. In view of this, any attempt to study economic progress in India in relation to the state, will have to be an attempt to consider the changing economic outlook of the state with reference to its changing structure and functions. So far as the first point is concerned we have merely to remember that geographical India is different from political India. In the first place, there is the obvious division of geographical India into two broad political divisions, namely British India and Indian States. Though there are many things in common both between the governments of these respective divisions and their people, there are vital differences inherent in the organisation of the political machinery prevalent in these divisions. The Indian States present among themselves a large variety, partly because of their size and status, and partly because of the resources at their disposal. The personal rule of the ruler has been in many cases tempered by Advisory Councils, consisting of men well-known for their administrative experience or expert knowledge, and efforts are being made to introduce representative institutions in some states. The ideas current in British India and the changes which occur from time to time in British India do influence the Indian States, but nevertheless, in considering the position of the states in relation to economic progress in India we must think of them separately from British India.

In British India also we do not have one governmental authority throughout the country. As we shall see immediately we shall have to remember the differences in the functions of the Central Government on the one hand and of the

Provincial Governments on the other, to be able to have a clear view of the economic progress in the country in relation to the state. Though there are many things in common between these separate units, there are bound to be differences in their economic outlook particularly in the future. To appreciate this possible tendency in the future, it would be convenient to consider the position of the British Indian state in three stages, first up to 1920; second, during the period 1921 to 1937; and third at the present moment.

The Bureaucratic State

Up to 1920, in British India we did have one state; it may be described as the Bureaucratic State. Though we had the Central Government and the Provincial Governments then as now, the Provincial Governments up till 1920 were merely the agents of the Central Government, and the methods and policies adopted in the Provinces were determined at the Centre on uniform lines. So far as the economic outlook of the Bureaucratic State in British India up to 1920 was concerned it was chiefly borrowed from England. As in England it was believed by the authorities here that the function of the state was mainly the maintenance of security, that is of law and order. The state was not concerned with measures calculated to bring about the prosperity of the people, that is to increase their productive capacity. It was assumed that such capacity would be better increased, if the people were left to themselves and that therefore, state interference in the economic sphere was not desirable. The actual working of this idea in practice will be reviewed later. We may however, anticipate some conclusions of that review, that the adoption of these ideas was unsuited to Indian conditions, and that it left us in an economically weak position. Though leaders in Indian opinion did point out the need for a change in the economic policy of the country, their voice was ineffective.

From another point of view, this state of affairs was inevitable. The Bureaucratic Government of India was only

an agent of the British Government. The history of this Government is chiefly one of an organised effort to consolidate British Rule in India. For this purpose, the Government of India had to act mainly as the Police State ; its strong arm maintained peace and order. An alien government trying to consolidate its power over a vast continent in this way naturally hesitated in taking bold steps for economic or social improvement, lest such steps came in the way of vested interests leading to discontent. Not having the sanction of public opinion behind its administration, the Government of India preferred merely to act as an efficient policeman.

Dyarchy and Bureaucracy

During the period 1921 to 1937, this position was changed due to the Montagu Reforms. Whereas the Central Government still continued to have the form of the Bureaucratic State, the Provincial Governments got some autonomy. They were however, organised as Dyarchical States, in which bureaucracy still retained its power in substance, though it was tempered to some extent by public opinion as voiced in the legislatures, and by the existence of Indian Ministers in charge of transferred departments. As we shall see later, this was a period in which a gradual change in ideas took place, and the need for the state to adopt measures for the economic improvement of the people was realised. Barring the change in the conception of the duty of the State towards the people, this difficult period did not result in any substantial improvement. In other words, at a time when the rest of the world including England, was radically changing in practice the functions of the state in the economic sphere ; when the state in other countries was taking over more and more economic activities with a view to control and guide productive activities, we in this country needed a process of education for the authorities to change over from old ideas to modern views. In other words, during the period 1921-37 the conception of the state regarding the maintenance of security

remained unaltered, with this difference that the state now began to accept in theory that the prosperity of the people was also the goal for which the state should strive.

Limited Democracy and Triarchy

Under the Government of India Act, 1935, we have a further change in the nature of the state in British India. Dyarchy has been abolished in the Provinces; they are now considered as separate units of Federal India, and each is to be governed by democratic institutions limited in a variety of ways in the form of special responsibilities of the Governor; and in the form of the continuation of the vested interests of the Imperial Services. In view of these limitations, the state in the Provinces may be described to have the form of Limited Democracy. The capacity of this kind of state in the Provinces to bring about more prosperous conditions for the people is further limited by the financial resources at their disposal. Besides, we have to remember the fact that the Bureaucratic State continues at the centre, and is due to be transformed into the Federal Government of India at an early date. The nature of the Federal Government will be such that the future Central Government may be described as the Triarchical State in as much as there will be three distinct groups struggling for power in that state, namely, (1) the representatives of the people in British India; (2) the representatives of Indian States and (3) the Viceroy. The prosperity of the people will depend on the actions both of the Provincial and the Central Governments, because though the Provincial Governments will be in closer contact with the people, the Central Government will have certain large economic policies under its control, the determination of which will affect economic life in the country. In view of the change in ideas referred to above, we may say that though the maintenance of security still remains the chief function of the state in India, the desire to bring about prosperity is now likely to be translated into

practice, but the effort will be within a limited sphere, with limited resources and limited power.

Security Services

We have seen that up to 1920 the state in British India was organised as one unit, that its form was bureaucratic and that so far as its functions were concerned it was wholly guided by the 19th century idea of preserving law and order, and leaving the people alone to shape their economic destinies. This will be clear if we analyse the expenditure of the Government in the years prior to 1921. We find that as a rule the military expenditure of the Government of India dominate its budget ; that it is invariably about 50 per cent of its total expenditure ; and that if we add to it the other expenditure on maintenance of law and order within the country, that is the expenditure on Police and part of the expenditure on Civil Services which were charged with magisterial duties, we find that the expenditure on Security Services was more than half of the total. Out of the remaining resources, the Government of India had to find certain fixed charges, such as interest on debt, sterling payments to England, and a costly Civil Service, all of which between them absorbed the greater portion of the remaining revenues. This left only a meagre amount of beneficial expenditure. This explains the comparatively slow progress even in education, leaving aside directly economic aspects of progress.

In pointing out that the Security Services absorbed the greater portion of the resources of the Indian Government, we must remember that it was not merely the security of the people of India on which these resources were spent. They were spent also for the security of British Rule in India ; and part of the military expenditure of India has always been for Imperial purposes.

Agriculture

The way in which this conception of the state prevented economic advance may be further realised, if we analyse in

brief, a few of the leading aspects of the economic life of the country during the period prior to 1921. Taking agriculture, the basic industry of the people first, we find that the whole land revenue administration of the country was governed by the theory of rent. Imbued with Ricardo's classical theories of rent, taught in British Universities, the Indian Civil Servant assumed that the same was applicable *in toto* to Indian conditions. He believed that land revenue did not have an element of taxation, and that it could be increased without doing any harm to agricultural prosperity. The rigidity of the land revenue administration and the burden of land revenue which was increased at each settlement were carried to such an extent that they became a nightmare in the life of the agricultural population. Due to this and other causes, the agricultural occupation has become unprofitable in most parts of the country. Whether it is the existence of tiny and fragmented holdings or the state of indebtedness of the farmer or a combination of these and other factors, we cannot get away from the conclusion that the majority of the population who follow this occupation have to do so in spite of its unprofitable nature because of the want of an alternative.

Famine Policy

There were a few redeeming features in this situation. In the first place the Government of India adopted a famine policy to help the affected areas. The underlying idea was security of life by prevention of starvation in areas of acute distress. In normal times, protective works were constructed with a view to increase the powers of resistance of the people to face a famine. However, laudable these humanitarian attempts may be, they can at best be described as indirect attempts to help the people, so far as economic progress was concerned. It was perhaps the same rigid adherance to the narrow conception of the state, whose function was security, that made the Government of India alive to the need of preventing people from starvation. We have some parallel to

this effort in the modern practice of giving doles to the unemployed in highly industrialised countries. The unemployed are thus kept content, leaving the capitalist structure of the state undisturbed. The famine stricken people in India were given similar help and kept content by the Government of India, lest they became a source of unrest and trouble to the police functions of the Indian State. If the Government of India had a broader conception of the duty of the state to the people in normal times, they would have taken adequate steps to organise direct beneficial services to help the agriculturist to produce more, and to improve his condition to such an extent that he may not be faced with starvation in times of famine. Besides the famine policy, the Government of India took some steps to help the agriculturist, by instituting the Departments of Agriculture and Co-operation. The Department of Agriculture was however, charged merely with the duties of information, advice, demonstration and research. Its work and its methods were such that even to the present day the average farmer in the country is ignorant of its existence. The Co-operative Department, started with the best of intentions, have not succeeded in creating a spirit of co-operation and self-help among the people ; in most cases the Co-operative Society is only one additional organised *sowcar* in the rural areas. In spite of the persistent agitation of leaders of public opinion in the country regarding the evils of land revenue policy and the need for state action for agricultural improvement, the Government of India were slow in realising the realities of the situation.

Industries

If we look at other aspects of economic life we find that the smaller industries in rural areas gradually suffered or went out of existence due to the competition of manufactured goods. The people who were thus thrown out of employment could not find sufficient scope in larger industries and had to go back to the land. The large scale industries could not with a few

exceptions make adequate progress because, the state, wedded to *laissez-faire* principles, did not believe in giving them any assistance. In fact the way in which in the name of these principles, the Indian Cotton Industry was penalised by an excise duty in the interests of Lancashire, is one of the most miserable chapters in the economic history of Modern India. In fact, it was assumed in responsible quarters that India was an agricultural country only, in the sense that it could not be and need not be industrial. The talk of industrial development in those days was almost ridiculed or treated with faint praise. In consequence, the pressure of the growing population on the land was increasing without an adequate outlet in industries, either small or large. Rural life has thus been demoralised, and people seem to eke out an existence without that interest in life which makes it noble and worth living.

Railways

So far as the development of transport facilities is concerned the different parts of India have been connected by a net-work of railways which has made movement within the country both for passenger and goods traffic comparatively easy and cheap. Whereas this is true compared with the state of the country a hundred years ago, if we compare the transport facilities in this country with those in other countries at the present moment we shall realise the inadequacy of the facilities that we have. Considerable work remains to be done to link up the rural areas with the main railway lines. This may be done either by the development of motor traffic or by having feeder railways wherever possible. This presupposes however, the existence of suitable roads in the interior for which great efforts have yet to be made. Even with reference to the existing railways, it must be pointed out that they link up chiefly the urban centres and that they are partly organised for military purposes. In the actual management of the railways in this country, the freight policy has not been conducive to the interests of this country. It has en-

couraged more the foreign trade than the internal trade of the country, and has thus been instrumental in helping foreign industries often at the expense of Indian industries. It is not possible to go into the other details of railway management such as for example, the huge contrast between the facilities afforded to the insignificant minority of those who travel in the higher classes, and the vast majority of the passengers who travel in the third class. We must however point out that in one important aspect the railway policy was a definite departure from the traditional policy of *laissez-faire*. Though the railways in this country were instituted with the help of companies, the initiative came from the state, which gave the inducement of a guaranteed interest to the Companies and maintained a general control over railway administration. Whatever the defects in the early history of the railways in this country, the contracts with the companies provided for the ultimate ownership of the state in due course. In view of this, the state will be the owner of most of the remaining railways in due course. We have thus a rather anomalous but desirable position inasmuch as we have, or rather are soon likely to have nationalisation of railways, under a government which is not socialistic in its outlook and methods.

Currency and Banking

In the sphere of currency and exchange, it has been well-known that Indian interests and the Indian point of view have been often subordinated to the requirements of the City of London. The manipulations of the Indian currency and the exchange ratio of the Rupee to the Sterling have been the subjects of the most acute controversy. The desire to continue this control which involves the subordination of Indian interests, is reflected in the Government of India Act of 1935, by which it is not possible for the Indian Legislature to consider questions affecting the currency system of the country without the previous consent of the Viceroy. In the sphere of the money market and the banking system no steps were

taken for long to develop the indigenous system ; the modern banking system has been confined chiefly to the cities and is not sufficiently co-ordinated with the indigenous system. We have thus a wide gap between the urban and rural areas so far as the movement of money within the country is concerned. The comprehensive survey of the situation made by the Banking Committees which reported a few years ago has revealed the weaknesses in the situation. But with the exception of a few pious wishes definite steps towards the improvement of the banking system to suit our requirements still remains a matter of the future. The problem has now been taken up by the Reserve Bank.

Security and Population

It is thus obvious that the Government of India concentrated its energies and resources more on security than on prosperity. With the security thus granted to the people of India the population of the country increased enormously. But in proportion to this increase the avenues of employment did not increase, with the consequence that we began to have an increasing pressure on the land. Agricultural life which had already become difficult because of reasons mentioned above now became precarious in the extreme.

Want of Equilibrium

This rapid survey of the situation in different aspects of economic life shows that though some progress has been achieved in some directions, there are many more acts of commission or omission which have not been conducive to real economic progress. In consequence, we are presented with a serious want of equilibrium in the economic organisation of the country at the moment. We have a vast and increasing population living on the verge of existence, and almost desperate life. Having lived for generations on an occupation which involves continuous loss and a perpetual state of indebtedness, they have come to believe that the environment in which they are placed is almost natural, from which

there can be no escape. The desire to improve their lot or the economic motive has died out because of the conviction that the fruits of such additional improvements are not likely to be their own. This miserable state of affairs affecting the large majority of the people is reflected in the other branches of economic life, inasmuch as industries large and small cannot flourish when the purchasing power of the majority of the people is so low. In other words, a comprehensive approach to bring about a balanced economic life in the country has not been made and the situation has been allowed to drift from bad to worse.

State Apathy

While this was happening the state was looking on ; it was beyond its scope to interfere ; the people of this country were suddenly brought under the full impact of western trade and industry ; but they were not fully equipped to meet the same with advantage ; the apathy of the state in the matter of direct help to organise the people into a strong nation must, to a large degree be held responsible for the increasing helplessness in which they found themselves. This helplessness was revealed during the War period, when we could not avail ourselves of the new opportunities to develop our industries ; it was further revealed during the recent depression when we found ourselves unable to resist its effects ; and it is now revealing itself in our inability to move with the world in its march towards economic recovery.

Unlimited Powers with a Limited Outlook

The state in India, before 1921, partly because it was a bureaucratic state with unlimited powers to carry out things promptly, and with a highly organised machinery at its disposal to execute its decrees, was in a strong position to undertake a system of planned economy in the interests of the country. But such an outlook was at the time alien to the spirit of the Government in the country. It was wholly guided by the nineteenth century idea of preserving law and order, and

leaving the people alone to shape their economic destinies. There were a few attempts calculated to remove misery or to increase the material welfare of the people, for example, the famine policy of the Government of India was intended to relieve distress and to prevent the occurrence of famines as far as possible. Under pressure of public opinion a few steps were taken to help rural areas by means of the institution of the Departments of Agriculture and Co-operation. But these departments have had a subordinate place both from the point of view of their status and resources, and in spite of honest intentions have been able only to touch the fringe of the problem.

Slow change in Outlook

This limited outlook had to be changed by the force of circumstances during the period 1921 to 1937. This was partly due to the effect of rapid changes regarding the functions of the state in economic life in the west, which were revolutionising the attitude of the people in England in these matters. *Laissez-faire* was dead even in England and state intervention in economic activities had come to stay. No longer could the British authorities stop the extension of the conception of the state in economic life in India which was hitherto desired by leaders of public opinion, and which could now be expressed to a greater degree than before under the Montford scheme of constitutional changes. In spite of this, it must be pointed out that the rigidity of the old conception in Indian administration was so strong, that the desired change required a process of education of the authorities in India, at a time when the western world was witnessing rapid change in their economic life and organisation.

Process of Education

(a) *Industrial Progress.*

During the War the British authorities realised for the first time that a stronger industrial India was a greater military asset to the Empire. This led to the appointment of the In-

dustrial Commission under the guidance of the man who controlled the Department of Munitions in India during the War, Sir Thomas Holland.

The possibilities of industrial development in the country were fully surveyed by this Commission. But the change in policy was not possible until what is known as the Fiscal Autonomy Convention was suggested by the Parliamentary Committee which considered the Government of India Act, 1919. In view of this, the Indian Fiscal Commission was appointed in 1921, with the result that the policy of Discriminating Protection recommended by them was adopted by the Government of India and the Indian Legislative Assembly in 1923, and we had the first Protection Act with reference to the steel industry in 1924. Since then we have had the development of several other industries by this policy, some of which would not have come into existence but for such assistance.

(b) *Railways.*

The Acworth Committee on Railways which reported in 1921 recommended among other things state management of railways, owned by the state. They also suggested several ways by which railway extension and improvement could be carried out and industries dependent on railways could be developed.

(c) *Roads.*

A few years later the Committee on Road Development reported as a result of which we have now a special fund started for the purpose, out of which the development and improvement of roads are being financed.

(d) *Agriculture.*

The Royal Commission on Agriculture surveyed the whole field of agricultural life in the country and issued a report which will remain a classic document for students of Indian Agriculture for many years to come. This gave an impetus to the Department of Agriculture to work more actively and

thoroughly for the development of agriculture. The Imperial Council of Agricultural Research came into existence as a result of the Commission's recommendations and is trying to co-ordinate research in agriculture, animal husbandry and marketing.

(e) *Banking.*

The Banking Enquiry Committee brought to light the serious want of co-ordination between indigenous banking and modern banking, and also emphasised the need for the development of rural banking which had also received attention at the hands of the Agricultural Commission.

Partly due to the reform in banking emphasised by these bodies and partly due to the need for a Reserve Bank of India pointed out by the Royal Commission on Currency and Exchange it was decided to bring into existence such a bank. The first attempt to create such a bank met with failure on account of constitutional difficulties. The Reserve Bank of India which has now been brought into existence, is charged among other things with the duty of finding ways and means, in due course, to develop rural banking on the one hand and to link up indigenous bankers with modern banks in the cities. Some steps in this direction are under consideration.

(f) *Rural Debt.*

Whereas these efforts may prove of some benefit in the future the difficulties of the farmers regarding their debt became serious due to the depression and consequent fall in the prices of agricultural produce. In view of this steps were taken by several Provincial Governments by legislation to relieve the farmer of his debt to some extent. At the same time Land Mortgage Banks have been brought into existence under state auspices to give long term loans to farmers under certain conditions.

(g) *Labour.*

With the development of industries in the country which was contemplated by some of the measures mentioned above,

problems of labour were likely to be created. The Royal Commission on Labour went into these problems and as a result of their recommendations labour legislation has been revised in recent years.

Theoretical change in the Conception of the State

Some of the steps mentioned above indicate the general tendency towards a broader conception of the function of the state in economic life rather than an achievement in direct benefit to the people. Some of them have been too recent for us to be able to trace their effects; some of them on the other hand are very narrow in their scope so far as the solution of the problem which they are attacking is concerned. In any case the mass of voluminous literature which these Commissions and Committees have produced during these years have at least resulted in the awakening of ideas, both among the public and the authorities which may be summed up by the statement that by this long drawn out process of education, the conception of the state in economic life has been made broader, and the state in India now accepts its duty to take positive steps for the prosperity of the people in addition to the maintenance of security.

During the period 1921-1937 the state in India as we saw before was altered to some extent in its structure. Those functions which if properly carried out were likely to result in economic progress like agriculture, industries, education, sanitation and so on were in the hands of the Provinces, who it was expected would be in a better position to manage these affairs by being in direct contact with the people. In spite of the gradual change in the conception of the duty of the state towards the people which we have seen, the good intentions of the framers of the Government of India Act, 1919, were defeated in practice, by the financial provisions of that Act which left rigid and limited sources of revenue to the Provinces, and the elastic sources of revenues to the Central Government. This resulted in wide spread discontent. The

discontent among the Provincial Governments themselves was partly allayed by the suspension of the provincial contributions which they were expected to pay under the financial arrangements then made.

Discontent among the Public

The discontent among the different legislatures in the country and among the public at their inability to achieve any thing substantial under the New Constitutional scheme took another form. They realised more than ever that economic progress was bound up in many respects with political liberty, and that in the absence of the latter the former could not be achieved. They felt in other words that progressive realisation of self-government in India was in substance a hollow formula, making it difficult for them to achieve reasonable progress in any direction. The progressive element in Indian politics as represented by the Swaraj party which joined the legislatures in 1924, retired in disgust from these bodies, and concentrated their energies on the organisation of a politico-economic movement, in the hopes of ultimately changing the existing order of things. The Swadeshi movement which was started as early as 1907, now became one of the chief planks of this political organisation. It took the form of an intense propaganda for hand-spinning and hand-weaving of cotton so much so, that the charkha came to be considered as the symbol of political freedom. The movement can be construed in one sense as calculated to give useful employment to the idle energies of innumerable cultivators in the country during the off season. The movement could also be construed as a method by which the people may be taught to develop and encourage local industries even at some sacrifice. It could also have a political lever in as much as, if it succeeded in reducing British imports to this country it was also likely to succeed in impressing upon the British authorities the need for loosening their political control over this country. In order to make the movement popular, the use of khaddar by

all classes of people rich and poor, was preached with a fair amount of success ; inasmuch as khaddar became a fashion, and in course of time the khaddar uniform came to be considered in the words of Pandit Jawaharlal Nehru 'the livery of our freedom.'

The Civil Disobedience Movement

This movement later took the form of the boycott of British Goods which was organised on a large scale and for some time affected our foreign trade considerably. When these methods did not succeed they were ultimately supplemented by the Civil Disobedience Movement which was an organised protest on a mass scale against the existing regime. In the early stages the movement took the form of breaking the salt laws, thus showing that the system of taxation in the country was unsuited to the condition of the masses. This politico-economic movement called forth an organisation involving sacrifice on the part of large numbers of people of various ranks in the country, which can be compared only to the sacrifices which nations demand of their subjects in time of war, with the exception that the movement was carried on, on the principle of non-violence. Whatever the drawbacks of the movement, it succeeded in creating a mass awakening among the people of the country for a more decent economic existence, to achieve which a determined effort in the political sphere was considered necessary.

The Economic Basis of the Movement

We are not concerned with the political aspects of this struggle. The economic basis of it however, needs to be explained. In the history of most countries revolutionary movements have had usually an economic background. We need not refer for example, in detail to the misery of the French peasants in the Bourbon regime which led to the French Revolution; nor need we refer to the exploiting of the masses in Czarist Russia which ultimately resulted in the sudden destruction of that regime. It has rightly or wrongly been

felt among large classes of people in this country that under British rule during the last 150 years, though life and property have been more secure than ever, it has been to a large extent a life without interest. The peace and security guaranteed to the average Indian by the British sword has resulted in a large increase of population, without a proportionate increase in the resources of the people. With the vast potential resources of the country comparatively undeveloped; with the increasing man power of the country in a state of comparative idleness, we were bound to witness a situation in which life should either decay because of want of interest, or rebel because of a desire for a better existence. It is possible by a large array of statistics to indicate a progress here and a progress there in the production of the country. The progress must however be in relative terms; first, in relation to the increasing numbers of people; second, in relation to the new types of wants and requirements which came into vogue in this country due to western contact; third, in relation to the technological advances in other parts of the world. If we did not keep pace with such progress in the rest of the world, we were bound to be relatively backward. The apathy of the state led to a situation in which such progress could not be achieved.

The Act of 1935

While the national consciousness was thus being roused with leaders of public opinion in jail, the British authorities evolved the Government of India Act of 1935. This ingenious piece of legislation which is full of contradictions, which compromises principles and which pleases nobody in this country, has created more problems for the country than it solved. The provinces are now supposed to be independent units in charge of certain defined functions. To all obvious appearances they have unlimited capacity to develop the resources of the people, but the Act restricts them in a variety of ways in any forward action. One of the main difficulties is financial. The resources left at the disposal of the Provinces are too meagre

for any bold scheme of reforms. The full share of income tax which has been theoretically assigned to them is not likely to be received by them for at least some years to come, and the period may be longer still. This relief is dependent mainly on the improvement in railway finance which however, is far from showing any substantial improvement. These somewhat cumbrous arrangements are mainly due to the conception of the state regarding security. The defence services have to be maintained by the Government of India and that Government should have therefore, sufficiently large and secure sources of revenue to maintain its military establishments. It is only after satisfying its need, that the Government of India can think of releasing surplus resources, if any for the use of the Provinces. In other words, provincial prosperity is thus subordinated to central security.

Financial difficulties under the New Regime

It was the realisation of this fact that the Act of 1935 so restricts the freedom of the elected ministers in the Provinces that it is not possible for them to satisfy the growing demand in the country for economic improvements, that led to the hesitation among the majority party in the country to accept office under the New Constitution. We thus had a most unparalled situation in the history of democratic institutions, is as much as, power was refused by those who alone could exercise it ; the tension was eased by tact on both the sides. Apart from the political significance of recent events in the country, the fact remains that in almost all Provinces, the budgets under the new Act have proved the urgent need of severe retrenchment on the one hand and of additional taxation on the other. If the responsible ministers that are now charged with the carrying out of governmental functions under certain restrictions are going to achieve direct or indirect economic progress by means of schemes such as (1) free and compulsory primary education; (2) extention of sanitary and medical facilities; (3) relief of the agriculturists from the pressure of land re-

venue and debt; (4) encouragement to the agriculturists in a variety of ways to do their best on the farm ; (5) the development of small industries chiefly in the rural areas and so on—if these and such other items of progress are to be carried out, drastic steps for retrenchment as well as new avenues of taxation will become necessary. This is so, all the more because by the provisions of the 1935 Act, it is not possible for the ministers to reduce expenditure in certain cases, say with reference to the salaries of the Imperial Services.

The Congress Ideals of Service

In spite of such severe handicaps, the determination to achieve as much good as is possible under present circumstances is reflected in ideas which are novel in their conception, and still more novel in their practical application. Not only in the history of Indian Administration but also in the history of other countries, the desire to infuse a spirit of service in place of the current practice of large pecuniary gains, among the persons who are called upon to run the administration, is unique, and owes its existence chiefly to the anomalies created by the Act of 1935. This is reflected in the voluntary acceptance of small salaries by Congress ministers. This determination to do best against odds may succeed in tapping unknown and undeveloped resources or energies in the process. While wishing the best of success to those who have undertaken these difficult tasks, the question nevertheless, remains whether such a spirit of service can be maintained for a period long enough to reach the desired goal. The question would not arise if those who are trying to infuse this spirit held undisputed power throughout the country. The question does arise because of the absence of such power and the consequent fact that tendencies in other parts of the country where Congress ministers are not in power may not be in the same direction.

Though it is possible to imagine that the forces which the Congress policy is likely to let loose, are bound to overtake in

due course the other Provinces where Congress is not in power at the moment, yet it is also possible to imagine that the existence of different policies in the other Provinces may prove obstructive to the realisation of the new spirit of service with the help of which Congress hopes to achieve its purpose.

The Central Government

Besides, though it is possible to influence to some extent the non-Congress provinces by these ideas, the difficulty of doing so, so far as the Central Government is concerned are almost insuperable. The Central Government controls economic policy in essential matters such as the protection of large industries, the making of commercial treaties, the control of currency, exchange and banking, and the control of the railway system. It is possible to imagine that difficulties may arise in carrying out the economic policy of a province, if the policy of the Central Government in other related aspects is not in the same direction. Under the Act of 1935, the Central Government was to be constituted as a triarchial state, in which it would be impossible for any single party to have a clear majority. This part of the Act which was not put into operation, has now been suspended, and we may assume that it will be revised before any action is taken.

Can the spirit of service be maintained for long ?

Another difficulty in the way of the Congress ideals of service is likely to be felt in course of time. So far as we can see, the Congress does not aim at a thorough overhauling of economic structure of society in the country. So long as life in other walks continues to be organised on the principle of pecuniary gains, there is bound to be a strong impetus to the best brains in the country to go in for those occupations which assure them such pecuniary gains. In the long run therefore, it will be difficult to maintain an equilibrium in the quality of the persons who wield political or administrative power, with the impetus of pecuniary gains reduced or removed from the field. No Government can subsist long with the deteriora-

tion in the quality of its personnel, and the Congress is bound to be faced with the dilemma, in view of the peculiar paradoxes of our situation.

Clash of ideals and methods

This brief analysis of the nature of the state in the country, that we now have, and this attempt at some anticipation of its possible working reveals the unfortunate facts, that we are about to pass through a period of transition, which will be characterised by a clash of ideals and methods, and therefore, by divergent results in different parts of the country. We are bound to have the creation of new desires and aspirations on the one hand, but in view of the clash referred to above, we are also likely to have the creation of new inequalities and new economic problems, which will tax the ingenuity of the future statesmen of the country to solve. From the point of view of the economic progress of the country as of progress in other directions, the future historian of India may have to record a chapter of fierce struggles and even of confusion and chaos, if this transition period for any reason becomes long. With the rapid march of events in the country in recent years and the spirit of nationalism which now pervades the younger generation, which is likely to be intensified by the ideals of the Congress which are in practice in some parts of the country, the citizen of the future will be impatient, if this transition is prolonged making the realisation of national aspirations difficult. If the future state in India is to achieve economic progress, even though divided into several parts for the purpose of convenience, it should be guided by one common spirit, instead of being cut up in compartments which move in different directions. The structure of the future state of India may therefore, have to be radically changed if it is to fulfil the desire for economic advance. One of two alternatives are possible ; we may have in course of time the domination of Congress ideals by force of numbers and organisation as well as by the spirit of service in practice. The second

alternative is a reconciliation of different points of view existing in the country, evolving a new state in which all may have a place for the common good.

Conclusion

It is obvious from this analysis of the present economical and political tendencies in the country that things are at present in a flux; that therefore, it is not possible to give even an approximately correct estimate of the way in which economic progress will be shaped in the near future. The only thing that can be asserted with confidence is that national forces have become sufficiently strong to assert themselves, and that we are passing through a process of transition in the political sphere, which will have far-reaching effects on our economic life and policy. When we have gone through that period of transition, let us hope that India shall be one, both geographically and politically, able to determine and execute her economic policy as one unit. Social and economic planning will not then be on paper but will also be in practice. In the process of achieving that unity, India will certainly be a stronger and healthier nation devoid of its present weaknesses. And let us hope that the free atmosphere of our political life will be accompanied by a higher economic level in production and a better economic arrangement in distribution.

CHAPTER III

EXPENDITURE

Acceptance of the progressive principle of public expenditure

With the change in the conception of the State with reference to economic life there was bound to be a corresponding change in the expenditure of the State. The Provincial Governments with responsible ministers who came in power in 1937 could no longer adhere to the old static financial policy. Under the old system certain revenues were expected from given sources with which the existing commitments of the government were balanced. If at any time there was a surplus by chance, it was utilised for new schemes of improvement. In place of this the ministers definitely accepted the progressive principle, " that expenditure should depend on policy ". It was now realised more than ever before, that with the increasing number of services which the government was gradually taking over, expenditure was bound to expand. In fact some of the Provincial Governments did not mind having deficit budgets. The Government of Bombay has been having deficit budgets for the last three years, though the first two years have closed with small surpluses. The outlook of the U.P. Government has also been similar. This natural desire for more expenditure to meet the requirements of more services has not been inconsistent with the cry for retrenchment in certain directions. The existing expenditure on certain departments was unduly heavy and left meagre resources for other more important activities of the State. It was with a view to bring about a more balanced arrangement that the Ministers undertook to retrench in some of the existing departments so that the sources thus released might be available for other services. As pointed out before however, there are constitutional limitations on such efforts; for example, it is not possible for the Ministers to reduce the salaries of the Imperial Services, whose high emoluments are guaranteed under the Act, and

cannot be changed except with the consent of the Secretary of State.

Limitations to the growth of public expenditure

So far as the desire to incur more state expenditure is concerned we have to remember that there are obvious limitations to the growth of such expenditure. The optimum of public expenditure is the point where the advantage to the community of an additional dose of expenditure is counterbalanced by the disadvantage of a similar dose of taxation. In other words, the ideal of public expenditure is to balance the disutility resulting from taxation with the utility resulting from the outlay. It is extremely difficult under our peculiar conditions in this country to realise in practice such an ideal state of affairs. On the one hand, we have an unbalanced system of expenditure as a legacy from the past ; on the other it is not within the power of the Ministers to completely overhaul the system of expenditure in the country, so that it may conform to the ideal mentioned above. With odds weighing heavily against them, what the Ministers can do is to work in the direction of the ideal and take steps to bring about gradually a more balanced system of expenditure in the hope that the ideal may be achieved at some future date.

Natural Limitation

The growth of expenditure is also limited by the possibilities of raising additional revenues. There are both natural and constitutional checks to the growth of revenue. The natural check is determined by the taxable capacity of the people. Taxable capacity may be briefly defined as the difference between the total quantity of production and the total quantity of consumption. The factors which influence these quantities may be both economic and non-economic. In other words, the taxable capacity depends not only upon production but also upon the propensity to consume and the propensity to save. To some extent the spirit and the national psychology of the people taxed are also important factors to be taken into

account. Among the economic factors affecting taxable capacity we may mention the distribution of wealth, the way in which taxation is raised and the way in which it is used. For example, expenditure on education and public health may increase the ability of the people to produce more and may also lead to the desire to save.

In our country with the estimated per capita income at less than Rs. 100 the taxable capacity will necessarily be small. The U.K. could raise Rs. 210 from the per capita income of Rs. 1000 during 1933-34; whereas British India could raise only Rs. 8 from the per capita income of Rs. 100 or less in the same year. In spite of this important limitation on the increase of revenues in the country, we may refer to two important changes which have recently taken place. Under Provincial Autonomy, the spirit and the psychology of the people taxed have definitely undergone a change because of the consciousness that the taxes are being raised by responsible Ministers. Further, it is well-known that the additional taxation is being utilised for the promotion of the welfare of the masses which in course of time is bound to increase taxable capacity.

Constitutional Limitation

The other limitation to the growth of revenue is constitutional, inasmuch as the Act of 1935 has put definite limits to the fiscal powers of the different units of the Federation. As already mentioned in another connection the need of securing stable financial arrangements at the Centre was paramount in the minds of the framers of the Act, with the consequence that though the Provinces have unlimited scope for further expenditure, they are faced with definite limits so far as their capacity to levy fresh taxation is concerned. Unless some way is found to remove this unfortunate conflict inherent in the Act, the Provinces will find it extremely difficult to make progress.

Growth of Provincial Expenditure

With these general observations, it will now be possible for us to review briefly the major tendencies in the expenditure of the Provinces during the period of Provincial Autonomy. Table II in Appendix II shows the growth of expenditure during the three years under review. We have taken the figures for the year 1936-37 the last year of the Montford period as the basis of comparison, and comparing with them the budgetted figures of 1939-40, we find that every province shows a rise in expenditure although in varying amounts and in varying proportions. Bombay and Bengal are in the vanguard so far as the rise in expenditure is concerned, Bengal having raised its expenditure by almost 25 per cent. We shall have occasion to observe later that though the achievement of Bengal is remarkable, the position is not gratifying if we take the liability into account. Among the major provinces Madras lags behind. The explanation in this case seems to be that during the period 1921-37 Madras had the largest increase in expenditure.[1] It is obvious from the table that the smaller provinces are likely to present a great problem to the financiers. On the one hand, they were behind the major provinces at the start, and on the other they have not been able to keep pace with them during the period under review.

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[1] **Growth of Expenditure between 1921-22 and 1936-37 in percentages :—**

Madras	..	26.7
Punjab	..	28.6
Bengal	..	12.0
U. P.	..	16.7
Assam	..	14.7
C. P.	..	11.9
Bihar & Orissa	..	22
Bombay	..	3

Though nominally Punjab has the highest percentage increase, the percentage of Madras over the high expenditure of that Province in 1921 is more significant.

Nature of Indian Expenditure

In order to have a proper grasp of the nature of state expenditure, it is usual to classify the same under two broad categories, namely, expenditure on security services and on social services. Though there are some difficulties regarding the exact connotation of these terms, it is generally accepted that expenditure on defence, on maintenance of internal law and order, including departments of law and justice, civil administration and the service of the debt, comprise the security services. On the other hand those activities of the state which are calculated to enhance the welfare of the citizens, such as, departments of education, public health, medical relief, agriculture and industry constitute the social services. In order to have at least a rough measure of the progress achieved in recent years, it would be better to have a comparative idea of the expenditure in India on these services compared with similar expenditure in other countries. For this purpose we have compiled a table for the year 1933-34 for a few leading countries and divided their expenditure into two parts, that on defence and that on social services. The corresponding figures for all-India have been included in the table for purposes of comparison.

	Total Expend. in millions	Expend. on defence in millions	% age of total Expend.	Per head exp. on defence	Expend. on social services in millons.	% age to total Expend.	Per head exp. on social services
				Rs. as. ps.			Rs. as. ps.
U. K. (£)	778	107	13.8	30 12 6	201.8	25.9	57 15 10
France (francs) ...	49,8811	10192	20.4	26 2 1	6620	13.3	16 14 11
Germany (Rm.) ...	6,189	749	12	7 5 4	1372	22.2	13 9 7
Australia (£)	64.7	22.6	34.9	45 1 0	11.3	17.5	22 8 6
Canada ($)	448.5	13.4	3	3 9 7	49.7	11.1	15 3 2
India (Rs.)	2053	442	21.5	1 10 1	17.5	8.5	0 10 5

The remarkable feature of India's expenditure as borne out by this table is that the security services absorb revenue as high in proportion to her wealth as in the case of the western nations. On the other hand her expenditure on social services lags far behind western standards and in fact is non-existent in some directions. It may be pointed out that this does not convey the entire picture, for in many countries large amounts are spent on social services by local bodies, and if we compare the expenditure of local bodies in this connection in our country we shall find it to be hopelessly inadequate. For example, in 1933-34 the expenditure of local bodies in England amounted to Rs. 435 crores against Rs. 53 crores in India. Education and Public Health are among the most important activities of local bodies in most countries. The appalling facts of illiteracy and ill-health stare one in the face wherever one may turn in this country.[1]

The above discussion establishes the general conclusion regarding the nature of state expenditure in India before 1937, and we shall now try to analyse in some detail the nature of expenditure in the Provinces in the period under review according to the same classification.

Expenditure on Security Services

The following table shows the expenditure on the security services in the provinces. These services include general administration, justice, police and jails. They do not include expenditure on defence which is a central subject, and therefore these figures do not give us an entire picture of the expenditure on security services in the country. The expenditure in the year 1936-37 has been taken as the basis of comparison in each case, and the budgetted expenditure for 1939-40 shows the growth in the intervening period.

[1] According to Sir John Megaw, formerly Public Commissioner with the Government of India: "Taking India as a whole the dispensary doctors regard 39% of the people as well nourished, 41% poorly nourished and 20% very badly nourished."

Province.	Population in lakhs.	Expend. in 1936-37.	%age to total Expend.	Expend. in 1939-40.	%age to total Expend.	%age increase or decrease.	Expend. per 1000 of population in 1939-40.
		(Figures in lakhs of Rupees.)					
Madras ...	445	558	35	570	34.5	2.1	1266
Bombay ...	180	328	27.5	307	20.2	—6.9	1706
Bengal ...	501	500	42.6	529	36	5.8	1058
U. P. ...	484	419	35	422	30.8	.75	870
Punjab ...	236	311	29	348	29	11.9	1474
Bihar ...	324	185	46	212	40	14.6	662
C. P. ...	155	167	34.7	163	33.7	—2.4	1006
Assam ...	83	63	22	80	26.7	27	964
N. W. F. P. ...	24	70	39.4	76	40.9	8.6	3166
Sind ...	39	78	21.7	84	22.4	7.5	2153
Orissa ...	83	57	37.4	62	31	8.8	747

We find that this expenditure shows a rise in all provinces except in Bombay and C.P. In Bombay certain items which were debited to 'General Administration' were transferred to 'Land Revenue'. If the necessary adjustments are made on this account amounting to Rs. 19 lakhs, it will be found that the expenditure on these services in Bombay is almost constant. In the case of Bengal, the release of the detenues has saved Rs. 22 lakhs. We shall in the first place analyse briefly the causes of this increase.

Cost of the New Constitution

Under the new constitution, the legislatures were greatly enlarged and in some provinces an upper house was instituted. The legislatures were filled with enthusiasm for reform and in consequence there were prolonged sittings in most cases. This necessitated an increase in the secretariat staff and involved additional expenditure. Another factor which contributed to the increase in some cases is the large number of ministers. In Bengal there are 12 ministers, in Madras 10,

in Bombay 7, in the U.P. 6, and in the Punjab 7. In Bengal the Prime Minister gets Rs. 3,000 p.m., and other ministers Rs. 2,500 p.m. The Congress Ministers have set a noble example ; by a self-denying ordinance they limited their salaries to Rs. 500 per month.

The following figures will give a comparative statement of the salaries and other contingent expenditure of ministers in different Provinces in 1939-40 (Budget) :—

Province	Expenditure in lakhs.
Madras	1·34
Bombay	·85
Bengal	4·50
U. P.	·74
Punjab	2·75
Bihar	·56
C. P.	·66
Assam	·93
N.W.F.P.	·59
Sind	·80
Orissa	·31

The additional cost on account of the constitutional changes on the whole was about Rs. 20 lakhs in Bengal, Rs. 4 lakhs in the U.P., Rs. 5 lakhs in Madras and about Rs. 12 lakhs in the Punjab. For obvious reasons the cost is higher in the non-Congress provinces.

In the Congress provinces wherever prohibition is enforced, the government had to strengthen the police forces, who are made responsible for its enforcement. The cost of such additional staff was about Rs. 2 lakhs in the district of Salem in Madras. The provision for the enforcement of prohibition in Bombay City is about Rs. 15 lakhs. Although one may differ as to the policy of entrusting this task to the police department it cannot be denied that it is the cheapest agency.[1]

[1] The Punjab Retrenchment and Resources Committee favour the transfer of the excise work to the Police as there is a duplication of functions at present. Report p. 45.

The question of the separation of the executive from the judiciary was much discussed during the last decade. The arrangement prevalent in British India was condemned as circumscribing the liberty of the people. The doctrine of the separation of powers, was advanced to ensure the liberty of the people. This important reform has been held over on grounds of finance. The U. P. legislature passed a resolution in favour of this reform during the Montford period. The Congress Government in the U.P. decided to separate the judiciary from the executive in 1939 in spite of difficulties. The matter is under the consideration of the Governments of the C.P., Assam, Madras and the Punjab. The Bombay Government have not been able to adopt this due to financial stringency, but if the U.P. could begin the reform with an expenditure of Rs. 3 lakhs, let us hope that the other governments will soon follow the bold example of the U.P.

Reorganisation

The Provincial governments have not been slow in the reorganisation of the administration. Most of the governments appointed retrenchment committees to advise them on the subject. The question of the abolition of the Divisional Commissionerships came under the examination of all the provincial retrenchment committees appointed during the periods of financial difficulties of 1921-23 and 1931-33. The Bengal Retrenchment Committee presided over by the late Sir R. Mukerji laid down one important principle for administrative reorganisation. They were of the opinion that all the posts which served as a connecting link only between two main agencies or served as a 'post box' should be abolished. The Divisional Commissioners and the revenue as well as the police circle inspectors came under this category. These agencies have no useful work and add to the burden on the provincial exchequer. The question of the Commissioners was a little complicated as they had some statutory revenue

functions. Although the committees had recommended necessary amendments, the recommendation could be easily shelved. Under the Government of India Act 1935 Revenue Tribunals are appointed and so a part of the difficulty is solved. The question of their abolition is seriously under consideration and the Assam Assembly refused to sanction the demand for this. It may be said that this antiquated institution should be soon abolished to release the funds for nation building activities.[1]

Another post which came under similar criticism by the Committees was the Deputy Inspector-General of Police incharge of the Criminal Investigation Department. It is well known on all hands that this department serves no purpose conducive to national welfare. It is better that the recommendation is given effect to without delay.

The stoppage of the Hill exodus on Government account has also contributed to some saving. This question was also agitating the minds of the public for many years. It was usual for the Governments to have two provincial capitals—one for summer and another for the rest of the period. In some cases like Bombay before the last depression there were three stations—Bombay, Poona and Mahabaleshwar. It was no doubt a costly luxury which the tax payers could ill afford and the abolition of this system in many cases is a welcome feature.

Among the major provinces the expenditure on Security Services per capita is the highest in Bombay,[2] where the heaviest item is expenditure on police ; the main problem is how to reduce this expenditure while retaining efficiency, and how to spend more on beneficent activities.

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1 The Punjab Resources and Retrenchment Committee has recommended a reduction of Divisional Commissioners from 5 to 3 as a compromise to complete abolition on similar grounds. The anticipated savings is Rs. 1.6 lakhs per annum. Report p. 82.

2 Cf. last column in table on page 45.

On the per capita basis, the small provinces of the N.W.F.P. and Sind show a very high expenditure.[1] This is due to the scarcity of population in these provinces. The overhead expenditure remains almost the same irrespective of the size of the province. Further a comparatively larger staff is required to discharge the primary functions of the government to maintain law and order. The incidence of crime is also heavy in Sind and N.W.F.P. This raises the question whether it is desirable to create small governor's provinces where a large proportion of revenue has to be spent on such primary functions, starving the beneficient activities. Such provinces are likely to remain backward for a long time to come. The problem facing the small province is that it has to live on fixed doles from the Central Government and on inelastic revenues. This is reflected in the budgets of small provinces which show no progress.[2]

We have discussed the causes of the increase in the expenditure on Security Services. If, however, we look at this expenditure in terms of the percentage thereof to total expenditure, we find a falling tendency, except in the minor provinces, where the tendency is in the opposite direction. This is a clear indication of the fact that in spite of some absolute increase in this expenditure due to causes explained above, relatively this expenditure has been kept under control in the major provinces, which have tried to find more resources for Social Services. The minor provinces would like to do the same, but they have such heavy burdens to maintain the Security Services in proportion to their resources, that they are not left with enough for Social Services. We shall of course be able to verify these observations when we discuss in detail the expenditure on Social Services, to which we now turn.

1 Budget Speech, N.W.F.P. 1938-39.
2 Budget Speech, Orissa 1938-39.

Expenditure on Social Services

In order to get a clearer idea of the progress of expenditure on these services in recent years, it would be better to compare it with the corresponding expenditure in the different provinces during the Montford period. The following table gives figures of such expenditure in 1935-36 as compared with 1921-22. We have taken the year 1935-36, as in 1936-37, the last year of the Montford period, certain changes such as the separation of Sind took place, which makes comparison difficult.

Provincial Expenditure on Social Services in 1921-22

Province	Population in lakhs (1921 census)	Expend. on social services in lakhs of Rs.	Percentage of total expenditure.	Expenditure per 1000 persons.
Madras ..	423	270	21.2	638
Bombay ..	193	281	18.7	1456
Bengal ..	466	164	16.2	352
U. P. ..	456	239	20.7	524
Punjab ..	207	165	18.7	797
Bihar & Orissa ..	340	82	18	241
C. P. ..	139	88	17.5	633
Assam ..	76	45	21.9	592
Total ..	2300	1334	19	582

Provincial Expenditure on Social Services in 1935-36

Province.	Population in lakhs (1931 census.)	Exp. on social services in lakhs of Rs.	%age of total Exp.	Exp. per 1000 persons.	Increase over 1921-22 in lakhs of Rs.	Percentage Increase over 1921-22.
Madras ..	467	429	27.3	918	159	59.2
Bombay ..	219	284	18.9	1297	3	1
Bengal ..	501	254	22.1	508	90	55
U.P. ..	484	301	25.7	622	62	25.8
Punjab ..	236	280	20.6	1187	115	69.6
Bihar and Orissa ..	380	147	26.2	386	65	79.2
C.P. ..	155	86	18	556	—2	—2.3
Assam ..	86	63	22.5	733	18	40
Total ..	2528	1844	23.8	729	510	38.2

These figures which include the expenditure on education, medical relief, public health, agriculture, veterinary departments, co-operation and industries, will show that all the provinces except Bombay and the C.P. devoted increasing attention to the nation building services during this period. The total expenditure increased by about Rs. 5 crores of which there was an increase of Rs. 159 lakhs in Madras and Rs. 115 lakhs in the Punjab. The percentage increase on the whole was 38, but Madras showed an increase of 60 per cent. and the Punjab 70 per cent.

It is obvious that the agricultural provinces benefited more than the industrial ones during this period. Madras had large resources available after the abolition of the Provincial contributions, and this enabled the Madras Government to spend more on Social Services. Of the two industrial Provinces, Bombay and Bengal, the latter could show some progress because of the special help that it received from the Central Government by way of 50 per cent. share of the jute export duties. But even then the progress of the provinces is quite insignificant as compared with the increased spending power left to them during this period.[1]

On a per capita basis the following figures will show the contrast between some of the provinces.

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[1] Increased spending power exclusive of Burma was as follows :—

(1) Under the Meston Settlement	..	Rs. 7 crores.
(2) By the remission of contributions	..	Rs. 9 crores.
(3) Additional Taxation	..	Rs. 4 crores.
(4) Central Aids—		
(a) 50% share of jute export duty.		Rs. 2 crores.
(b) Grant from Central Road Development Fund	..	Rs. 1 crores.
Total	..	Rs. 23 crores.

		1921–22	1935–36
Bombay	..	Re. 1-7-4	Re. 1-4-9
Punjab	..	Re. 0-12-10	Re. 1-3-2
Madras	..	Re. 0-10-5	Re. 0-15-4

The position of Bombay is well reflected in these figures. It shows deterioration rather than progress. The future of Bombay had been mortgaged by the Bombay Development and the Lloyd Barrage schemes ; the interest charges on the capital sunk in these schemes have been a heavy drain on its resources. This made it difficult for Bombay to spare more resources on Social Services at a time when other Provinces were making progress in this direction. On the one hand the distribution of resources in the Montford period was adverse to the industrial provinces of Bombay and Bengal ; on the other, Bombay did not receive any special consideration of the type that Bengal did. At the same time, the resources of Bombay were limited by the huge debt on doubtful schemes mentioned above, one of which has proved a failure and the other was for the Province of Sind, now separated.

We may note that the expenditure on the social services in the different provinces was distributed in different ways, each Province having its own peculiarity. Bombay devoted itself more to education ; Madras to medical relief ; and the U.P. and the Punjab to agricultural development. The table on page 53 gives the expenditure on Social Services in the Provinces in 1939-40 as compared with 1936-37.

It will be clear that the popular governments have shown considerable attention to the hitherto starved nation building departments. Most of the Provinces are devoting a larger amount of public revenues to beneficial activities and the progress during these three years has almost been equal to that of the preceding 15 years. The progress in different provinces varies, though Bombay, the U.P. and Punjab are quite outstanding in their performance.

Expenditure on Social Services

	Population (in lakhs.)	Expenditure in 1936-37 (in lakhs of Rs.)	Percentage to total Expend.	Expenditure in 1939-40 (in lakhs of Rs.)	Percentage to total Expend.	Percentage increase in 1939-40 as compared with 1936-37	Expenditure in 1939 per 1000 of population, (according to 1931 census)
1	2	3	4	5	6	7	8
Madras	445	440	27.75	465	28.65	5.7	1049
Bombay	180	254	21.1	373	27.76	47.6	2073
Bengal	501	256	22	356	24.3	27	711
U. P.	484	313	25.45	397	29.20	28	824
Punjab	236	281	26	343	28.83	22	1458
Bihar	324	127	31	149	28.39	15.7	460
C. P.	155	92	19	102	21.18	12.1	658
Assam	83	65	22.6	71	24.49	10.6	849
N. W. F. P.	24	34	19	41	21.75	17.8	1667
Sind	39	45	12.8	55	14.64	19.5	1410
Orissa	83	39	25.8	46	23.49	17.5	566
Total	2554	1946	23.8	2377	26.4	23.2	930

Column seven will show the percentage rise in expenditure during 1939-40 as compared with 1936-37. Bombay has raised its expenditure by about 50 per cent. from 254 lakhs to 373 lakhs, which is indeed remarkable. The other provinces have raised their expenditure by about 15 to 20 per cent. except Madras.

In spite of the better terms granted to Bengal in the recent arrangements, the expenditure on these services is about Rs. 0-11-3 per head as against Re. 1-0-5 per head in Madras. It is only in five provinces viz., Madras, Bombay, the Punjab, Sind and N.W.F.P. that the expenditure exceeds Re. 1 per head.

Expansion of services

The activities which have been expanded are spread over all the departments and to maintain continuity some of the Governments have created Special Development funds. The Government of the Punjab has created a fund of Rs. 55 lakhs from the realised surplus of 1937-38. The object is the prosecution of an intensive policy of development and reconstruction mainly in rural areas. A sum of about Rs. 19 lakhs is already budgetted to be spent mainly on consolidation of holdings, expansion of co-operative activities, water supply and agricultural improvements. Bombay has also set apart a sum of Rs. 50 lakhs from the probable surplus of 1938-39. The attention is mainly devoted to services which will benefit the agriculturists and the object of creating such funds is to maintain uniform progress irrespective of financial vicissitudes.

The Government of the C.P. is setting aside a part of the excise revenue for Rural Development whereas Bombay and the U.P. have set part a large amount for such development from current revenues.

Rural Development

For some years past the importance of organised efforts on a large scale for Rural Development has been universally recognised. Mahatma Gandhi was the first to draw pointed

attention to the need for efforts of this kind. The All-India Spinners' Association and the All-India Village Industries' Association were started under his inspiration and are working under his guidance. Later, the Government of India realised the urgency of similar work, and in the Budget Speech for 1935-36 it was announced that the Government of India proposed to make a grant of Re. 1 crore from the estimated surplus for 1934-35, for distribution to the Provinces for the economic development and improvement of rural areas. At a later stage it was proposed to transfer to this fund the unallocated balance of the surpluses in the Central Budget and thus in the end a sum of Rs. 261 lakhs was earmarked for the purpose. This amount has been distributed on the population basis to the Provinces in two instalments, Rs. 93 lakhs in the first, Rs. 103 in the second; and Rs. 15 lakhs has been earmarked for developing the co-operative movement. It was obvious that such spoon-feeding was inadequate and it was essential that the Provincial Governments who are responsible for this work should take over the responsibility. In order to tackle this vast problem some of them have decided to take up the work on a large scale. The Government of the U.P. took a lead and set apart a sum of 10 lakhs during 1937-38, 20 lakhs during 1938-39 and 40 lakhs during 1939-40 for this purpose. The Government of Bombay followed suit and provided 45 lakhs in the year 1939-40 for the same purpose. It is intended to increase the provision for this scheme in subsequent years in these two provinces and make it a recurring item as more funds become available so that the proposed activities may be expanded.

Aims and Objects

The aims and objects of any scheme of rural reconstruction are to raise the standard of living of the people. It is essential for the rehabilitation of rural life that the problem should be faced boldly on all fronts by the adoption of comprehensive measures. We shall first consider the way in which the Cen-

tral funds have been utilised and then review the efforts of the Provincial Governments.

(a) Schemes of the Government of India

The Government of India asked the Provinces to submit schemes for economic development and improvement of rural areas. The word 'economic' was defined in its widest sense *i.e.* it was meant to cover measures designed to improve the actual money incomes of the people as well as those designed to improve their health and education. Although the Provinces have discretion in drawing up their schemes, the Central Government has indicated certain categories which in its view cover most of the pressing needs of village life and offer the most practical benefit.

These categories are as follows :

1. Sanitary measures :
   (a) anti-malarial schemes.
   (b) village water supply including well-boring.
   (c) village sanitation including drainage.
2. Consolidation of holdings.
3. Village roads.

The Government of Madras has distributed its grant on (a) Rural water supply, (b) Village communications and (c) village sanitation. The Government of Bengal has a number of schemes but the main are (1) the establishment of dispensaries and improvement of water supply, (2) the improvement of village drainage, (3) the establishment of agricultural demonstration farms and, (4) the improvement of cattle and fodder crops. The Punjab has reserved most of the grants for the consolidation of holdings and the improvement of water supply. The other governments have various schemes coming within the above category. In Bombay and the U.P. the central schemes are overshadowed by provincial schemes. Though the grants were decided upon five years ago, the Provinces have not been able to fully utilise the amounts, and they are still able to draw from the balance,

lying with the Central Government, which amounted to Rs. 83 lakhs at the end of 1938.

(b) The Schemes of Bombay

The schemes embrace all the departments. Under agriculture it is proposed to adopt measures for land improvement and water supply. A widespread campaign to prevent further loss of surface soil is to be carried out in a planned manner. For the complete eradication of deep rooted weeds, it is proposed to promote a society to supply heavy tractors for ploughing on a hire purchase basis. Encouragement will be given to the sinking of new wells and deepening of the existing wells by grant of loans on easy terms to diminish scarcity of drinking water for men and cattle. Improved seeds and improved implements will be made available by the Better Farming Societies to be promoted under the scheme. There is considerable neglect, ignorance and waste of manures and the supply of these could be materially increased without involving additional expenditure. Intense educative propaganda and demonstrations will be organised, and schemes to make available some of the organic manures to the cultivator are also under consideration.

In order to develop village industries, it is essential to have an Institute for handicrafts in this province. There is no such Institute as in other provinces where the problems of improvement in machinery, equipment, design, etc. as well as training of artisans in the production of varieties of articles according to the changing taste, needs and wants of the people can be undertaken. It is proposed that there should be one such institution in each division of the province having at least the following sections : cotton weaving, leather tanning, lacquer ware, wool weaving, pottery, dyeing of cloth and printing.

Cottage industries such as sericulture, development of fibres, gold and silver thread industry, industries connected with brass and copper, wood and leather are under consideration

for development. There are many others in the list which we need not enumerate.

In order to improve the marketing organisation for the agricultural produce and the products of the cottage industries the government have passed the necessary Marketing Act and have appointed Marketing Officers. It is recommended by the Provincial Board of Rural Development that a Cottage Industry Emporium should be established in Bombay City for the sale of various cottage industries products of the Province.

For such a comprehensive scheme a vast organisation and a large field force is required. The government proposes to establish three main types of agencies (a) non-official (b) official and (c) village workers.

The non-official agency consists of the District and Taluka or Group Development Boards and Honorary Village Workers. These have been constituted in many districts. The Boards are entrusted with the following functions.

(1) To assist and advise the officers of the Rural Development Department in carrying out schemes of development of rural areas approved by the Government.

(2) To organise and supervise all rural development work in the district.

(3) To control and supervise the work of Taluka Development Associations.

(4) To prepare schemes of improvement of rural areas for submission to Government.

(5) Generally to advise the officers of the Rural Development Department on the economic aspects of rural areas and to act as a focussing centre for all rural development activities.

Honorary village workers will be appointed to carry out such elaborate plans on all fronts. Although village panchayats and multi-purpose societies will have paid secretaries, unless non-official help from villages as well as from outside is received and the response of the people is satisfactory, real progress will not be possible.

For the purpose of the better utilisation of the government official agency it has been decided to reorganise the Agricultural and Co-operative Departments. It will ensure greater efficiency and the economical use of government resources and will avoid duplication. The Co-operative Department with the necessary expansion has been put in charge of all rural development work and propaganda. The Agricultural Department will confine itself to education and research and cease to do any propaganda or demonstration. The staff so released has been transferred to the Co-operative Department which has been designated as the Co-operative and Rural Development Department. The Registrar of Co-operative Societies is also the Director of Rural Development.

To enable the Director of Rural Development Department to perform satisfactorily his duties he has been given the assistance of one Deputy Director drawn from Deputy Directors of the Agricultural Department. The present Assistant Registrars have become Rural Development Officers. With their added burden, it is felt that their charge will become too heavy. It is proposed to appoint five additional Assistant Registrars and Rural Development Officers to reduce the extent of their charges. Below in the ladder will be the Rural Development Inspectors in charge of a revenue sub-division and further below Assistant Development Inspectors. The Rural Development Inspectors will be in charge of about four talukas and their main duty is to organise the work planned by the Department. The Marketing Inspectors will study local markets, the ways and means of marketing, and organise purchase and sale unions to link up the sale and purchase work of the various societies.

The most important link in the organisation is the training of 1000 rural workers, about 50 per district, with the object of preparing work by educating the village people for tackling their social, economic and other problems and also to achieve the well-being and happiness of the villagers. These

workers will carry the message of the government to the masses and the success of the whole scheme depends upon them. Before they are sent to the villages, they will receive one year's training in all possible branches covered under the development programme, such as (1) agricultural education to be popularised in the areas concerned; (2) co-operative methods of work for reconstructing rural life; (3) cottage industries likely to succeed in areas concerned and (4) the management of the village panchayats, and will receive Rs. 8 per month as stipend. After completing the course they will be put in the grade of Rs. 20-1-35.

With the expansion of the Department the need for more specialised staff will be felt. It is proposed to appoint one Assistant Registrar for Co-operative Finance. The proposal also provides for the establishment of price intelligence services, and these will be in charge of the Marketing Officer and his assistants.

(c) The U.P. Scheme

Although the primary aim of rural development in this province is the same as in other provinces, *viz.*, to rebuild the social, economic and cultural life of the countryside, the method is different. The Government felt that the required improvement must come from within and should not be imposed upon the villagers from outside. With this end in view the guiding principle followed by them is decentralisation of authority. The scheme is allowed to be worked with the maximum degree of devolution of power and local initiative. It is controlled and worked mainly through non-official agencies, while the help of the official and technical elements lends administrative experience and technical ability to the work. This method stands in contrast to that of Bombay, where the responsibility rests with the official, while the non-official agencies are available for advice and guidance.

As regards organisation, there will be a Registered Better Living Society in each village, a Union of such societies for

each unit, a District Rural Development Board for each district, and a Provincial Rural Development Board for the whole province. The staff will consist of a village guide for each village, an organiser for each unit, an inspector for each district, a superintendent for each division and the Rural Development Officer and his assistants at the headquarters.

The Better Living Societies elect a representative panchayat for the village, with a secretary and a chairman. The panchayat has to obtain the necessary funds for village improvements partly from villagers themselves in cash, kind or labour, and the rest from the union in the shape of a contributory grant up to a maximum of two-thirds of the total cost of an improvement scheme. The main activities are concentrated on a unit which is selected perfectly round some existing institution like a middle school or a dispensary, in order to carry out the work in a comprehensive and systematic manner. The development programme includes improvement of agriculture, cattle breeding and cattle welfare, extention of medical relief, mass education, marketing and rural credit.

Departments of Agriculture and Co-operation

It will be convenient to deal with the work of Agricultural and Co-operative Departments at this stage, because of its intimate contact with rural problems, the expenditure on which will be found in Table III in Appendix II. The Rural Development work is in charge of the Agricultural Department in the U.P. and the Co-operative in Bombay.

The functions of the Agricultural Department are research and investigation, demonstration and propaganda, supply of agricultural material direct to the public, and agricultural education and engineering. The Co-operative Department is concerned with the improvement of economic conditions by inculcating the habits of thrift and providing ready channels into which these habits can be directed; to facilitate the formation and the working of societies and to educate the agricultural and industrial classes in co-operative ideals and methods.

With a large percentage of the people dependent upon agriculture, the majority of them submerged in debt, we need not discuss the scope for good work by these departments. Under the popular governments a great expansion has taken place in their activities. The Agricultural Department has intensified the work of demonstration and propaganda. It provides more seeds, manures and implements, besides disseminating knowledge through magic lanterns, agricultural literature and so on. Arrangements have been made for the supply of better seeds to the cultivators. The work of intensifying the raising of money crops, the development of the fruit and vegetable industry and setting up a suitable arrangement for improved marketing of agricultural products has been undertaken. The Governments of Bombay and Bihar have established Provincial Marketing Departments. The Government of Bengal has set up a Committee to investigate the problem of jute in all its bearings, and another to investigate the problem of improving the prices of paddy and rice. Assam has provided for the establishment of model villages as a part of the special rural uplift scheme and has under consideration schemes for agricultural colonies and agricultural schools. The C.P. and Sind governments have also provided for the establishment of model villages while Bombay and Bihar have established more agricultural schools. The work of the Co-operative Department has considerably increased consequent upon active measures for the relief of rural indebtedness, and to cope with this increased responsibility the department has been reorganised in most provinces. Madras, Bengal, Punjab, C.P. and Assam have debt conciliation machinery and Bombay has recently enacted legislation for the same. In the new regime many additional boards have been established, and in Bengal the cost has risen by 24 lakhs on this account.

As a result of inadequate attention given to these subjects in the past, the task of lifting the masses from the depths of misery, ignorance and poverty has become onerous. In spite

of such increased activities, the problem defies solution. The only happy sign is that the governments are evincing keener interest and taking proper steps with courage and determination.

Education

We find that India is hopelessly backward in education. Whereas in other democratic countries more than 90 per cent. of the population is literate, the figure stands at only 8.3 for India. In western countries, females stand almost on a par with males in matters of literacy, the figure for literate females in India is not more than 2 per cent. There were over 6 million children between the ages of 5 and 14 in elementary schools during 1933-34 in the U.K. with a population of 45 millions, while the total number of pupils in all grades was only 13 millions in India during 1936-37 with a population of 27 crores. In other words, for one pupil in school, there were two children of the school-going age outside. Whereas the public education services of Great Britain are responsible for an expenditure of nearly £ 106 millions, the Provincial Governments spent Rs. 11·4 crores during 1936-37 and will spend Rs. 12.8 crores during 1939-40.

We may note that all the Provinces in India have by legislation (passed during 1918-26) indicated their acceptance of the principle of compulsion in primary education. The provincial enactments vary in scope and character, but it is realised that the goal of universal primary education cannot be attained without the adoption of the principle of compulsion. Since the late Mr. G. K. Gokhale introduced his bill in the Imperial Legislative Council in 1911, leaders of public opinion have constantly urged the need of compulsion and there is no hostility to this except on the ground of finance. The preamble to the Bombay Primary Education Act of 1923 declares it to be the policy of Government, that the universal, free and compulsory elementary education for boys and girls should be reached by a definite programme of progressive expansion.

The Bombay Compulsory Education Committee, 1923, recommended that compulsion should be introduced in all city municipalities within seven years.

Table III in Appendix II gives figures of expenditure on education incurred by the Provinces. The Government of Bombay has been spending the largest amount per head among the provinces on primary education. The expenditure has been 11 annas per head in Bombay against 6 annas in Madras and 1 anna in Bengal. During the year 1938-39, the Government of Bombay decided to impose a cut of Rs. 7.15 lakhs in grants to those municipalities which were expected to develop their own resources to meet the increased cost of education. Simultaneously a lump sum of Rs. 25 lakhs was provided for expansion and improvement of education, the share of primary education being Rs. 12 lakhs. During the year 1939-40 the Government restored the cut in grants of Local Bodies for Primary Education imposed during the year 1932-33. In addition a sum of Rs. 17 lakhs was granted for expansion and improvement of primary education, and Rs. 6 lakhs from the Special Development fund for buildings for primary schools.

The Government of Bihar has provided funds to make education free and compulsory in the municipalities situated at District Headquarters, for the promotion of mass literacy programme, the establishment of basic schools, and for providing libraries for groups of villages. The Government of Bengal are providing each year a sum of Rs. 5 lakhs with a view to supplement the laudable efforts of some of the Local Boards to utilise the provisions of the Bengal Primary Education Act to make education free and compulsory. They have undertaken to improve the quality of teachers and to provide trained teachers at a cost of Rs. 19 lakhs.

The other governments have also taken measures on similar lines. The underlying objects are to expand and improve primary education with a view to foster literacy. Many prim-

ary schools are opened in new areas and primary education is made free. Village library movement, circulating libraries, adult education and refresher courses are the methods employed for the removal of illiteracy among the adult population.

The real difficulty as has been pointed out above for mass literacy is of finance. The cost of introducing compulsory primary education in Madras has been estimated at between Rs. 6½ crores and Rs. 7½ crores, and in Bengal at about Rs. 2 crores.[1] Fresh taxation for the purpose or the reduction in the salary of the primary school teachers is not practicable. The Vidya Mandir scheme is introduced in the C.P. as a partial solution of the problem. If any person is willing to endow funds adequate for running a school, the government will undertake to provide one. The Government themselves have started about 200 schools. But it is doubtful whether this will meet with general success as the scheme depends on charity.

In the Wardha or the Basic Education Scheme, education is to be imparted through handicrafts and products therefrom are to be sold to the public. It is estimated that if the products can be marketed, each child will pay for the whole period of his education. It is claimed that this "self-sufficient" education solves a triple problem. The citizen, having known some crafts, can earn his living and it will thus solve the problem of unemployment. The general criticism that our education is too literary will be met; and the state will be relieved of financial embarrassment. The scheme has been approved by the Central Advisory Board of Education with certain modifications. Teachers for basic schools are being trained by different governments and the schools will be started soon. It is too early to estimate the success of the scheme.

[1] Interim Report, Indian Statutory Commission, page 269.

The popular governments havc not been content with primary education only. Secondary, University as well as Professional institutions have also received their attention. Many of the secondary schools have been converted into vocational schools. The Government of Bengal gave special grants to the Dacca College, and that of Bihar to the Patna University to expand University courses.

Medical Relief and Public Health

Medical and the Public Health services serve a common end although through different channels. The latter concerns itself with precautionary methods, which reduces the incidence and spread of disease. The other concentrates on the cure of the diseases. They perform twofold functions, preventive and curative. The prevalence of a large number of prevéntive diseases and the insanitary conditions are too well known to require elucidation. The economic wastage resulting from this situation has been well summarised in the following resolution of the All-India Medical Research workers :

"The Conference believes that the average number of deaths resulting from preventible disease is about five to six millions, the average number of days lost to labour by each person in India is not less than 2 to 3 weeks in each year, that the percentage loss of efficiency of the average person in India is not less than 20 per cent. and that the percentage of infants born in India who reach wage earning age is about 50 while it is quite possible to raise this percentage to 80 or 90.

The Conference believes that the greatest cause of poverty and financial stringency in India is loss of efficiency resulting from preventible diseases."

Table III in Appendix II shows the expenditure on this important department. There has been a substantial increase of expenditure under this head. Mention may be made of the efforts to solve the problem of village water supply, the provi-

sion for the purpose being as follows during the three years under review :

	Rs. lakhs
Madras	18
Bombay	28·25
Bengal	8
Punjab	3·5
N.W.F.P.	10
Assam	1·5
C.P.	2·5

Among the new schemes mention must be made of the health unit scheme first introduced in 1923 in Madras. There is one trained health officer in charge of public health administration in each district with at least one health inspector. The subjects with which this district health staff deals are the investigation and control of communicable diseases in rural areas. It makes plans and estimates for simple sanitary projects, and takes steps to remedy defects in village drainage and water supply. It is also responsible for propaganda work by lantern lectures, posters etc. The demand for this service from the public grew, and it was decided to have one intensive health unit scheme in a selected area to demonstrate the benefits that would accrue thereby to the health and welfare of the rural population. The Government of Bombay has also approved of this scheme and a small provision has been made for the purpose. The Government of Bengal has set apart about Rs. 12 lakhs for such Rural Public Health units.

Among other matters to which serious attention is given we may mention efforts to combat epidemic diseases, which includes free distribution of quinine, anti-malarial schemes, prevention of kala-azar etc. The provision for this by the Government of Bengal has been raised to about Rs. 8 lakhs per annum from Rs. 4 lakhs before 1936-37. The Governments of Bombay, Madras, the U.P. as well as Punjab are setting apart Rs. 1½ lakhs annually for the purpose.

The following table will show the position regarding the availability of medical aid in the different provinces.

	Number of hospitals and dispensaries	Number of beds
Madras	1161	9043
Madras City	33	2146
Bombay	288	4100
Bombay City	39	2280
Bengal	1070	3703
Calcutta	37	3203
U.P.	441	6958
Punjab	784	9835

It may be noted that most of the medical facilities are concentrated in cities and towns. The cry for better and greater medical aid in rural areas is as intense as it is for better and more facilities for education. In any scheme of regeneration of village life, the programme for the extension of medical facilities has its own place. One may argue that the essential feature of hospital organisation is that the patient must come to the hospital for such medical assistance as may be required. On the other hand the medical practitioners are not willing to migrate to villages, as they do not feel sure of their future, but prefer to concentrate in urban areas where the profession is already overcrowded. The solution is to subsidise medical practitioners in rural areas. The system qualitatively hardly differs from the English Poor Law system. The practitioners, willing to settle in specified villages can obtain a subsidy from public funds, in return for which they must render a certain degree of public service. The Government of Bombay has provided for the extention of medical facilities by subsidising medical practitioners during 1938-39 as well as 1939-40. During the latter year about 200 such dispensaries have been opened. Bihar, C.P., Sind and Assam have also adopted this system. In addition the Governments of Sind and Assam have started travelling dispensaries with government subsidy. In sparsely populated tracts this may be a better solution.

In addition to these efforts, the increasing interest of the Government and of the educated public in the great problems associated with the ill-health, pain and suffering affecting such large numbers of people in the country shows a great awakening. The realisation of the importance of these problems, has led to the determination to combat these evils by organised work. In spite of grave deficiencies still apparent in many directions, the public health movement has now gained momentum, and may be expected to improve the playsical well-being of the people of India in a reasonable time.

Industries

On account of the policy of *laissez faire*, the Government in this country has taken a very lukewarm attitude towards industrial development. Even when Departments of Industries were started in the different Provinces a few years ago, their scope was limited to information, research and advice and in some cases to demonstration. As a rule the activities of these Departments were kept at a low ebb by granting them only limited funds.

It has now been acknowledged on all hands that the development of cottage and small scale industries is one of the most important and urgent needs of India to help rural reconstruction on the one hand, and to utilise the large raw material resources of the country on the other. In many respects these industries can be supplementary to the large-scale industries, and ways and means can be devised by which unhealthy competition between them and the large-scale industries may be eliminated. The magnitude and the nature of the problem are such that unless the State takes the initiative and is prepared to spend large sums of money on systematic lines, progress will be difficult.

When the popular Governments came into power in 1937, though they were anxious to take forward steps to develop industries, they found that they did not have even elementary data regarding the condition of these small industries in the

Provinces. Before they could successfully build a comprehensive scheme of improvement it was essential to have such data. This situation is a sad commentary on the attitude and work of the preceding Governments regarding this problem. In order to make up for this gap, most of the Provincial Governments appointed Survey Committees to collect the necessary data and also to suggest lines of improvement. If the growth of expenditure on Industries in the Provinces has been limited, it is explained by the above facts. It is to be expected that some of the schemes which have been already put into operation will now receive fresh impetus when the results of these surveys are available.

The expenditure on Industries in the different provinces is given in Table III in Appendix II. It is evident that it forms only a small percentage of the total expenditure. The total expenditure on industries came to Rs. 133 lakhs or 1.5 per cent. of Provincial expenditure. Even in an industrial province like Bombay the expenditure has risen to only Rs. 13 lakhs or 1 per cent. of the total expenditure, while in Bengal it is only 21 lakhs or 1.5 per cent. of the total expenditure. The inadequate attention given to this vital problem will thus be obvious.

Civil Works

This item includes expenditure on construction, maintenance, and repairs of public buildings and roads. Table IV in Appendix II will show the expenditure on civil works during 1939-40 as compared with 1936-37. Leaving aside the question of public buildings we shall confine ourselves to road communications which are the arteries of the economic and social life of the country. Road works have long been considered a highly convenient form of public works. It is now generally acknowledged that expenditure on public works is both convenient and useful as an instrument of public expenditure policy particularly in times of economic depression. In India the public works policy has been incidental to the posi-

tion of the budgets, expanding during prosperity, and contracting during depression which is bound to accentuate the evils of depression.

The inadequacy of road mileage in India is well known. By the end of 1936-37 there were 11 miles of metalled road per 100 sq. miles of area or 1 mile of such road for 3300 persons. At the end of 1929-30 there were 71000 miles of surfaced road in British India which rose to 82000 by the end of 1937-38. During this period of eight years there was an increase in road mileage of 11,000 or 15 per cent. In 1926-27 the total provision of local and provincial road maintenance was 383 lakhs. In 1937-38 the figure was 407 lakhs or an increase of 6 per cent. in a decade of great development of traffic.

It is obvious that the general road condition of this country is no credit to anyone concerned. But the evil does not end here. Most of the roads are either of strategic importance or link up big urban centres. The needs of the rural areas are hardly attended to. The peasant is the backbone of the country and everything that benefits him increases the wealth of the country. The peasant has to compete in a world market and rural roads will improve his selling capacity. The Jayakar Committee emphasised the importance of a great extension of road making in the interest of rural development, and general social progress.[1]

The development of roads has been looked upon with suspicion because of its competition with railways. There need be no controversy about this, and roads and railways should be considered as complementary to each other and not as competitive. This view has been endorsed by the Agricultural Commission[2] and other authorities.

The following figures will give an idea of the highway finance of the provinces during 1937-38.[3]

1 Indian Road Development Committee Report, 1927, pp. 16-19.
2 The Report of the Royal Commission on Agriculture, p. 377.
3 Figures from the "Combined Finance and Revenue Accounts 1937-38."

Receipts	**In lakhs of Rs.**
Under Indian Motor Vehicles Taxation Act	14
Under Provincial Motor Vehicles Taxation Acts	133
Less compensation to Local Bodies as required by the Acts	59
Net Provincial Receipt from these Acts	74
Total Provincial receipt from Taxation of Motor Vehicles	88
Assignment to the Central Road Development Fund for the benefit of Provinces	117
Total Receipts	205
Expenditure	
Provincial: on original works	113
on maintenance of roads	210
grants-in-aid to Local Bodies in addition to the compensation	114
Total	437

Central Road Development Fund

In the middle of the last decade (1927), the Government of India appointed a Road Development Committee under the chairmanship of Mr. M. R. Jayakar. As a result of the recommendations of the Committee, excise and import duties on petrol were raised by annas 2 per gallon from 1928-29 for the purpose of a road development fund. From 1931 a surcharge of 25 per cent. is levied on that duty which augments the fund. The fund is distributed as follows :[1] (1) 15 per cent. is retained by the Central Government to defray the administrative expenses and to promote schemes of research. (2) Of the remainder, a portion is allotted to the Central Government

[1] The amount collected on petrol used for aviation purposes is excluded from this fund.

for expenditure in States and administered areas, and also to each Province in the ratio which the consumption of motor spirit in each area bears to the total consumption in India during the same period.

As the arrangement stands at present, after the allottments are made, the fund is retained by the Central Government, and can be drawn by the Provincial Governments for approved schemes. The amount can be spent for the following objects only:

(1) Construction of new roads and bridges.

(2) Reconstruction and improvement of existing bridges.

(3) Interest and amortisation of loans incurred after 21-4-1934 for the above objects.

(4) In special cases, on maintenance, improvement or reconstruction of roads and bridges constructed from road funds since 1930 and from loans after 1934.

The expenditure on new construction by the Provinces equals the receipts from the Central Road Development Fund. The expenditure on the maintenance comes to about Rs. 2 crores and the grants-in-aid given to the Local Bodies for the purpose of roads comes to about Re. 1 crore. The income from the Motor Vehicles Taxation comes to about Rs. 88 lakhs; the rest of the expenditure is found from general revenues.

As we have seen the expenditure on maintenance of roads has not increased in proportion to the increase in road mileage. With the development of road transport however the expenditure will increase. It is a heavy charge on current revenues and a burden to the general tax payers. In equity it is clearly desirable that these service charges should be recovered from those who use the roads. The taxes paid under the M.V.T. Acts which are really in the nature of fees for the benefits received from the highway should be adequate to meet this expenditure. Taxation of vehicles is a common method of taxing motor transport in other countries. In India the

provinces, except Madras, have not yet attempted to develop systematically this source of revenue as will be clear from the following figures for 1938-39.

Province	No. of Motor cars.	Receipts under M.V.T. Acts (in lakhs of Rs.)	Taxation per car. Rs.
Madras	22,000	81	368
Bombay	31,000	44	142
Bengal	28,000	21	75
U.P.	17,000	11	65
Punjab	20,000	8	40

It may be suggested that the other provinces should re-adjust their Motor Vehicles Taxes so that they may realise larger revenues.[1]

Road Development

The Central Government derives a large amount, about Rs. 5 crores from import duties on motor cars, their parts and accessories, tyres and tubes; and from import and excise duties on petrol. These sources should really be utilised for road development, and if the Central Government can release these funds for the purpose it will be a welcome relief to all concerned.

In the alternative, the development of roads may be financed from loans. So far only Rs. 20 lakhs have been spent on roads from loans by the Provinces. The general principle may be laid down that any scheme of road development which ensures additional revenue to meet the service of the loan incurred for the same, should be accepted. There may however be schemes of road development which can be approved on other general grounds, though they may not strictly conform to this financial principle. In such cases, what we have to decide is whether the possible benefits from such schemes outweigh the loss of general revenues to meet the service of

[1] The Punjab Resources and Retrenchment Committee has made a similar recommendation. Report p. 205.

the debt for the same. In view of the very favourable debt position of most of the provinces, and the favourable rates at which money could be raised in recent years and even now, one wonders why this policy has not been vigorously adopted.

Famine Relief

From 1928-29 the constitution of the Famine Insurance Fund changed radically. Since then it is called the Famine Relief Fund and it provides for its main and primary object relief of famine proper, famine being defined as one due to drought or natural calamity. No other direct expenditure can be charged to it.

Under the Devolution Rules of the Old Constitution, each province was required to set apart a prescribed sum to build up such a fund which was deposited with the Central Government. Under the Government of India Act, 1935, the responsibility of making such provision has devolved upon the provinces. The Provincial Governments except Assam have passed the necessary legislation to put the arrangement on a statutory basis. The following are the details about the annual assignment for famine relief, the balance of which after meeting charges if any, is to be carried to a fund till it reaches a prescribed maximum.

Province	Annual Assignment for Famine Relief. (In lakhs of Rs.)	Maximum limit of Famine Relief Fund
Madras	5	60
Bombay	11	63
Bengal	2	12
U.P.	16	55
Punjab	2	10
Bihar	2	10
C.P.	10	50
Sind	2	12
Orissa	2	10

The Punjab has been caught in the grip of serious famines in recent years. The effect of the famines on the finances of the Punjab Government are as follows :

	1938-39	1939-40	Total
	(In lakhs of Rs.)		
Direct Expenditure	27	39	66
Remissions and suspensions	28	16	44
Taccavi loans	37	38	75
Total	92	93	185

Pensionary Charges

These include superannuation charges and allowances and equated value or commuted value of pensions charged to capital, exclusive of charges on account of commercial departments. The charges were Rs. 585 lakhs for 1936-37 for all the provinces and have risen to Rs. 663 lakhs by 1939-40, the rise being spread over all the provinces. This increase is due to increase in salary granted during the post-war period and the tendency is likely to persist for some time to come.

In course of time, with the Indianisation of the Services, and reduction in salaries, one may expect a corresponding reduction in these charges.

Interest Charges

We shall discuss this item of expenditure along with the general problem of the Public Debt of the Provinces in a later chapter.

CHAPTER IV.

OLD SOURCES OF REVENUE

Growth of Revenue

The growth of revenue since 1936-37 the last year of the pre-autonomy period is shown in table V in Appendix II. The revenues of all the provinces except Sind have increased although in different proportions. But a few adjustments are necessary to have a comparative idea. There has been an accounting change to satisfy the definition of Provincial revenues given in the Government of India Act, 1935. Under this arrangement certain receipts of local bodies which were formerly directly credited to them, have to pass through the provincial books of accounts. An equal amount is paid back by way of compensation to the local bodies and debited to appropriate expenditure heads. Secondly, there were some post-budget proposals in some provinces likely either to increase or decrease the revenues. These have been indicated as far as possible at relevant places. In Madras, taxation measures were adopted after the presentation of the budget for the year 1939-40. One was a general sales or turnover tax and the other a tax on sales of tobacco. As no estimates are given of the probable receipts, it is not possible to adjust accordingly. In the case of Bombay, there were certain post-budget proposals which have been duly adjusted in the table. In Bengal, the figure should be reduced by Rs. 93 lakhs being the amount credited as required by the accounting changes explained above. In Assam, a tax on agricultural incomes has recently been levied. It may be expected that there will be an increase of revenue on account of this.

After allowing for these adjustments, it can be concluded that there has been an increase in the spending power of the provinces. Even if the figures are adjusted to the level of prices, it will be seen that there has been a real increase in revenue. This has been so in spite of the fact that the land revenue is either stationary or contracting and excise revenue

is being gradually reduced. This has been largely achieved by imposing new taxation coupled with Central aids. Excepting Orissa all the provinces have resorted to additional taxation in varying degrees. Before discussing these new sources of revenue, we shall in the first instance review the old sources with which the Provinces started their career in 1937.

Land Revenue

The taxation of land has been almost universal and of immemorial antiquity and this has been the case also in India. Although it has receded in the background because of the development of other taxes, it is still a chief form of taxation in many countries. In India it contributed the largest revenue to the Government before the reforms of 1921. Although it has now been surpassed by Customs in its yield, it still holds its own in the Provinces.

The principle which governs the levy of land revenue appears to be different in different countries. The system prevailing in India is not only different from them, but among the Provinces there is no uniformity. There is the Permanent Settlement in Bengal, Bihar and Orissa, some parts of the U.P. and some parts of Madras. In the other Provinces there is the Temporary Settlement. The settlements are either made with the *zamindar* as in Bengal, or with the village as a whole as in the Punjab, or with the *ryots* directly as in Bombay and Madras.

The Permanent Settlement

The following are the main features of the Permanent Settlement : (1) The settlement was made with the *zamindars* who were declared proprietors of areas over which their revenue collection extended. (2) The assessment fixed on the land was declared to be unalterable forever, and the Government undertook not to make any demand for the augmentation of the public assessment, in consequence of the improvement of their respective estates. (3) The assessment was fixed

approximately at ten-elevenths of the rents received by the *zamindars* at the time of the Settlement.

The Ryotwari Settlement

In Ryotwari Provinces the following features need examination :

1. The basis of land revenue.
2. The method of valuation.
3. The pitch of assessment.
4. The period of revision.
5. The graduation of enhancements.

The basis of land revenue: In the U.P., the Punjab, and the C.P. the government demand is theoretically based on economic rent. In Madras the assessment is based on the net produce, *i.e.* the gross produce minus the cost of cultivation. The cost of cultivation is calculated on the assumption that all labour is hired and includes an allowance for the labour of the cultivator and his family. In Bombay, the rate of assessment is arrived at empirically with reference to general economic considerations.

The method of valuation: The method of valuation is simpler in the U.P. and the Punjab. The settlement officer inspects the villages and groups them into assessment circles possessing a general similarity of soil and physical character. The rent rate is determined for each class of soil, the chief guide for which is the recorded rentals of land under ordinary crops. In Bombay the method is to divide the soil into different classes according to quality and to fix the assessment after inquiring into its circumstances and previous history.

Pitch of assessment: The pitch of assessment also varies from place to place. In Madras the state share of produce has been fixed at half the net produce as defined above. In the U.P. since the amendment of the Land Revenue Act in 1929 the share of the state has been limited to 40 per cent. of net assets. Before that time the share was 50 per cent. The Punjab system has been modelled mostly on that of the U.P.,

the state share being 50 per cent. of net assets. By an amendment of the Land Revenue Act in 1928 the share has been fixed at 25 per cent. The rule of taking half the net assets was also applied to the Central Provinces, but the Chief Commissioner asked for a latitude of 50 to 65 per cent. of the rental to be fixed as land revenue and the Government of India gave the permission. It is only in Bombay that no such limit had been put to the pitch of assessment.

The period of settlement: The period of settlement also varies in different provinces, but 30 years is more common which prevails in the Punjab and the United Provinces as well as in Bombay. In the Central Provinces the period varies from 20 to 40 years in different parts.

The graduation of enhancements: The enhancement of land revenue at each settlement must be gradual. Certain limits have been laid down in this connection. In the U.P. it has been limited to 1/3 of the expiring revenue. In Madras it has been limited to 18 2/3 per cent. since 1924. In Bombay the limits were 100 per cent. for a single plot of land ; 66% for a single village, and 33% for a single taluka.

Growth of Land Revenue

Table VI in Appendix II will show the yield of land revenue in 1939-40 as compared with 1936-37. The figures show that there has been a rise of Rs. 150 lakhs in the total Provincial revenue from land. The major provinces except Punjab show a rise. This has been achieved even after the land revenue demand was reduced in different provinces as follows. In Madras the demand was reduced by Rs. 75 lakhs since 1937-38. The C.P. has granted Rs. 10 lakhs as abatement of land revenue in 1939-40. The Government of Bombay also gave a remission of Rs. 10 lakhs in heavily assessed areas during 1939-40 due to fall in prices. The Assam Government granted a remission of Rs. 6½ lakhs in 1938-39. It is now learnt that the Revenue Sub-Committee of the Assam Legislature have recommended a 50% remission for all holdings.

paying an assessment of Rs. 16 or less. As regards estates paying more than Rs. 16 the rate of reduction that has been recommended is understood to be a little higher than the current remissions.

The main cause that has contributed to higher receipts is favourable agricultural seasons. This has enabled the government to grant lesser remissions and suspensions and recover past arrears in some cases.

Nature of Land Revenue

Let us now consider the burden of land revenue. It was a matter of controversy for many years whether land revenue should be considered a tax or rent. The Indian Taxation Enquiry Committee closed this question by classing it as a tax.[1] The arguments for land revenue being treated as a tax are (1) the State in India has never claimed universal ownership; (2) that the Government has conferred proprietory rights in permanently settled areas, and that it imposes no restriction on sale of *ryotwari* land; (3) that land revenue is a compulsory payment to the State and exceeds the amount of economic rent, and that (4) land revenue forms a dividend from national income.

Land Revenue and (a) the principle of convenience

We shall now consider how far land revenue conforms to the accepted principles of taxation. The land revenue demand being fixed during the currency of a settlement, once the settlement is made, the cultivator knows what precisely he has to pay in the shape of assessment on his land. Thus land revenue conforms to the principle of certainty. Secondly, land revenue is payable in instalments after harvest, therefore, it is convenient to pay. But the income from which land revenue is to be paid fluctuate according to the vagaries of the monsoon. This means that ability to pay is sacrificed to certainty and convenience.

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[1] The Indian Taxation Enquiry Report, para. 84.

(b) Principle of economy

The cost of the land revenue establishment is high in proportion to the revenue realised. But this establishment performs multifarious other duties, and it is not possible to assign the exact cost on account of the collection of land revenue. This being so, it is not possible to say whether the land revenue conforms to the principle of economy.

(c) Ability to pay

It may be pointed out that although it is a direct tax, there is no progression in land revenue. It does not take into account the amount of income, the way in which the income is earned and the way in which it is spent. It is wholly regressive. Dr. Gregory has expressed the view that land revenue is essentially a tax on things and not on persons, and so it is not a tax to which the doctrine of progression can be applied.[1] But we may remind him of the considered view of Dr. Marshall, who observed that taxes were paid by persons and not by things ; things were channels through which taxes struck persons.[2]

Inequality of Land Revenue

While dealing with the 'system prevailing in different provinces, the differences therein have been pointed out. Due to these differences, besides other anomalies, the most important anomaly that exists is the inequality in the burden of land revenue. We may take either the area or the per capita basis in different provinces for the purpose of comparison, and we shall find that the burden varies enormously.[3] If the incidence of land revenue has to be determined, it must be calculated only on a provincial basis, because an All-India calculation will be of no value for persons given above.

[1] The Taxation Enquiry Committee Report, para. 89.
[2] The Memorandum to the Royal Commission on Local Rates and Taxes, 1899.
[3] See Footnote, p. 83.

Land Revenue and Legislative Control

In the case of the land tax the main principles, the methods of valuation, the pitch of assessment, and the period of revision were all laid down by executive order. The Joint Parliamentary Committee which considered the Government of India Act, 1919, recommended that the time was ripe to bring this under legislative control. Bills intended to bring Land Revenue under Legislative Control were introduced in the Legislative Councils during the Montagu period. In the Punjab, the U.P. and the C.P. the bill codifying the existing practice was passed. In Bombay only recently the Land Revenue Code has been amended to implement the recommendations of the Land Revenue Assessment Committee of 1924.

Bombay Land Revenue Amendment Act

The Bombay Land Revenue Amendment Act 1939 seeks to bring the process of revision of the land revenue settlement under statutory regulation. The opportunity was taken to modify certain principles of the land revenue system having financial and economic bearings.

Hitherto land revenue was determined on the empirical estimate of the value of the land or the profits of cultivation.

Province	Incidence per acre of Land Revenue on fully assessed area in 1935-36.			Incidence per capita in 1935-36.		
	Rs.	as.	ps.	Rs.	as.	ps.
Madras ..	1	10	5	1	10	3
Bombay ..	1	4	1	2	3	11
Bengal ..	0	11	11	0	10	2
U. P. ..	1	2	6	1	7	7
Punjab ..	1	8	6	2	4	4
Bihar and Orissa ..	0	5	7	0	7	3
C. P. ..	0	9	9	1	8	6
Assam ..	1	4	3	0	9	8
N.W.F.P. ..	0	5	9	1	2	0
Sind ..	2	0	8	4	7	5

Now the standard rate of assessment is to be fixed for each group formed on the consideration of certain factors[1], such that it may not exceed 35 per cent. of the average of the rental values for a period of five years. The Taxation Enquiry Committee as well as the Bombay Land Revenue Assessment Committee recommended that the rate should not exceed 25%. Though it was not found possible to accept this recommendation, the amendment marks an advance in view of the fact that hitherto the rate was about 50 per cent. of the rental value. It has been further laid down that the enhancements will not exceed by more than 50 per cent. in case of a survey number and 25 per cent. for a taluka instead of 100 per cent. and 33 1/3 per cent. respectively prevailing before. In this case also the recommendation of the Bombay Land Revenue Assessment Committee to limit the enhancement to 25 per cent. has not been accepted.

Even then the Act marks an advance in two respects. So far the practice was that the rise in value due to the improvements by or at the cost of the holder was exempted. Now such improvements will be taken into account for assessment purposes after 30 years. The change can be justified on grounds similar to those advanced for the levy of death duties although in practice it will be difficult to differentiate the improvements due to social causes from those due to personal labour.

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[1] Some of the factors are :—

(a) climate and rainfall.
(b) markets.
(c) communications.
(d) history of the collection of land revenue.
(e) wages.
(f) prices.
(g) ordinary expenses of cultivating lands for the purpose of agriculture.
(h) rental value of land used for agricultural purposes.

Secondly, provision is made to declare settlements made hereafter to have been based with reference to prices of certain staple commodities, and the government have reserved the right to give a rebate in the case of a fall or levy a surcharge in case of a rise of prices.

Although the Act is an improvement on the existing system, it falls short of the requirements. On the one hand the problem is to take away as much of the unearned increment as possible, and on the other, the tax should not be an unbearable burden to the payer. The problem is complicated because of the revenue consideration which makes it difficult for the authority to carry out the reform to its logical conclusion. The recent amendments will reduce the land revenue demand in Bombay by about Rs. 45 lakhs or about 12½ per cent.

The Act breaks new ground by bringing the principles and the methods of land revenue settlement under statutory regulation. It provides for the publication of the land revenue assessment report and for inviting objections, if any. Any aggrieved person has the right to ask the Government to refer the objections to the Revenue Tribunal for opinion and review. The Revenue Tribunal may submit its own opinion. Thereafter the settlement report submitted by the Collector together with objections, is to be laid before the Legislature where it is liable to be discussed in the form of a resolution.

Necessity of revising the system

The main problem of land revenue is to overhaul it in such a way that the incidence may become equal in different provinces and as between different tax payers. The amended Bombay Land Revenue code does not go far in this respect. Any solution prescribed will have to take note of the features of the Permanent and Temporary Settlements, and therefore, the problem will have to be tackled on an All-India basis to bring about equity in taxation. We may however draw upon the experience of other countries with a view to ascertain whether some remedies towards this end can be suggested.

Principal features of taxation of land in other countries

Although the principles which govern the levy of the tax appear to be different in different countries, in most of the countries the system contains the following features :

1. A flat rate on annual value at about 10 per cent. or a tax on capital value.
2. A progressive tax on income which includes income derived from land.
3. In most of the cases a death duty or other capital tax.
4. A local rate.

Taxation of capital value

The Taxation Inquiry Committee which considered the question of taxing the capital value of land rejected it on the following grounds.[1]

1. Capital value does not bear a constant relation to annual value.

2. The valuation will be very difficult and expensive.

3. In order to determine capital values the Settlement Officer would in many cases have to arrive at annual value which is the basis of assessment at present.

4. In *ryotwari* areas the capital value can be credited to a single person, but in areas where the tenancy legislation is in operation the rents are controlled. There may be two or more capital values of different beneficial interests in the land to be considered.

Recommendations of the Taxation Inquiry Committee

The Taxation Inquiry Committee recommended that the basis of settlement should be the annual value by which term they meant the gross produce less cost of production, including the value of labour actually expended by the farmer and his family on the holding and the return for enterprise.[2] As regards the rate of assessment the Committee recommended

[1] T.E.C. Report, para. 101.

[2] Ibid. para. 103.

that the standard rate should not exceed 25 per cent.[1] This scheme fails to give real relief to the farmer, as it retains the present system in all its essentials, except that it suggests a reduction in the rate.

The Punjab Land Revenue Committee

This Committee which reported in 1939 made an exhaustive inquiry with a view to see whether the principle of income tax could be applied to the assessment of land revenue. Unfortunately the main question was evaded by the Committee on the grounds that there was no popular demand for the change, that the difficulty of maintaining proper accounts due to mass illiteracy was great and that the fiscal interest of the state was against such a change. The Committee, however, recommended some relief to the small holders at a cost of Rs. 52 lakhs. The introduction of sliding scale with reference to changes in prices has also been suggested to relieve the burden of land revenue.

Proposed Remedies

In view of historical traditions, and also in view of the diversity of conditions in different parts of the country, it is difficult to evolve a perfect system of land revenue which will conform to all sound principles of taxation. But in our opinion a determined step should be taken to overcome all difficulties as far as possible in the interests of an equitable system of taxation, which will on the one hand put the burden on those most able to bear it, and on the other give an impetus for better work to the most important class of producers in the country.

With these considerations in view we suggest the following changes :

1. In *ryotwari* areas, the assessment should be permanently determined on the annual value at the time of the settlement, as defined by the Taxation Enquiry Committee.

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[1] Ibid. para. 105.

The rate of assessment should be fixed at 12½ per cent. which is the effective rate at present in the permanently settled areas.

2. At the same time, the income from the land should be subject to the general income tax in all areas, irrespective of the fact whether they are at present ryotwari or permanently settled.[1]

3. The exemption limit for the general income tax to be thus imposed on land incomes should be fixed at Rs. 1,000 or Rs. 1,500.[2]

In the first place, the necessity of periodical revision of settlements with all the troubles it causes will be obviated. The burden on the land will be more equitable, and will be borne by those most able to pay. Those with low incomes will pay only 12½ per cent. of the annual value, and this will enable the state to get at least a part of the unearned income on the land of small holders. The large landholders who now escape taxation will be required to pay according to their ability. On the whole, the system will be uniform throughout the country, and the present inequality of incidence of land revenue will go. There will no longer be the complaint about the regressive nature of this tax. At the same time, the innumerable small cultivators on the land will have that impetus to work better which they lack now, because they will feel that they will now be in a position to enjoy the fruits of their labour. In conjunction, with other rural reforms like legislation for the relief of indebtedness, such a step to overhaul the land revenue system in the country will go a long way in giving a real interest in life to the rural population.

We must frankly admit that the total receipts from the reduced land revenue and the new agricultural income tax

[1] A committee has been appointed by the Government of Bengal to advise regarding the Land Revenue System in Bengal.

[2] The exemption limit in Assam is Rs. 3,000 and in Bihar Rs. 5,000.

will be less than the present land revenue receipts. Exact estimates are not possible. But it can be asserted that the loss will be made good in other ways, as this reform will increase general prosperity in rural areas and therefore the taxable capacity of the people in other directions. It may also be pointed out that whereas the Permanently settled areas will gain in revenue, the Ryotwari areas will lose in revenue by this proposal. This will necessitate a change in the existing financial arrangement between the Centre and the Provinces ; for example, the aids recently given to some of the Permanently settled areas can then be withdrawn, with the consequence that the Centre would be in a position to increase the share of General Income Tax to the Provinces.

Provincial Excise

By excise is meant a tax or duty on home produced goods either in the process of manufacture or production. It is an internal consumption tax. Generally it includes duties on alcohol as well as non-alcoholic commodities.

In India this revenue is collected under different names and is assigned to different authorities. In the Provincial fisc this item represents the revenue collected in connection with the control, manufacture, sale, consumption and other operations connected with alcoholic liquors and hemp drugs. It excludes import duties on the above articles as well as excise duties on other articles and on salt.

Excise Policy

Without going into the details of the excise system in India we shall give in brief the history of the excise policy of the Government of India in view of the importance of the subject at the present moment. The general intention of the Government in connection with the excise was to raise a maximum of revenue with a minimum of consumption. The Secretary of State for India in his despatch of 1888 to the Government of India observed that in the interest of the Indian people as well as in the interest of the Indian Treasury the excise system

of India must always be based upon the considerations that (1) an extension of the habit of drinking among the Indian population is to be discouraged, and that (2) the tax on spirits and liquors should be as high as possible without giving rise to illicit methods of making and selling liquor. Subject to these considerations the Secretary of State urged that as large a revenue as possible should be raised from a small consumption of intoxicating liquors.

This policy of the Government has been subject to criticism. The late Mr. G. K. Gokhale while speaking before a meeting of the Temperance Society in Lndon in 1889 said that the consumption of liquor, moderate or immoderate is opposed to the sentiments of the great majority of the people of India and that in the pre-British days the state did not derive such a large revenue from the control of the liquor trade. Almost at the same time Sir Roper Lethbridge said in the House of Commons : " I believe that even an extreme measure of prohibition of sale of intoxicating liquors would not only meet with any resistance from the people of India but should in fact be most popular in that country ".[1] Resolutions were also moved in the House of Commons condemning the fiscal policy of the Government in encouraging drinking in defiance of the opinion of the inhabitants.[2]

To assuage public opinion in England the Government of India issued a despatch in 1890 outlining the excise policy which in substance remained the same. But even then the excise policy continued to be the subject of criticism by enlightened public opinion in the country, and by the temperance society. The Government of India appointed a committee to review the excise administration in India in 1904. The important measures taken on the recommendations of the committee were (1) to suppress illicit methods of all kinds (2) to discourage consumption without encouraging illicit

[1] Hansard, 1889.
[2] Ibid.

methods (a) by levy of a tax as high as possible (b) by reduction of shops (c) by regulating and suppressing the sale of liquor.

From that date to the reforms of 1921 when the excise administration was transferred to the popular ministers, the official policy remained the same. In spite of the policy of reducing consumption the revenue was gradually mounting up. The official reports point this increase as a sign of growing prosperity of the people and the suppression of illicit practices. In a country where drink is not indulged in as a luxury as in the west, after having satisfied the primary wants, to the intelligent public in the country the increase was not a sign of growing prosperity but of an increasing tendency towards moral and physical degradation and ruin.[1] A fresh chapter was opened in the excise policy with the introduction of the Montagu Reforms. The non-co-operation movement led to a shrinkage of excise revenue and gave a temporary impetus to the temperance movement. Resolutions were moved and passed in the provincial legislatures urging the adoption of a policy of restriction of drink. In some Provinces Excise Committees were appointed. The Bombay Excise Committee of 1922 recommended that the Government should declare the total extinction of excise revenue as the goal of its excise policy. The Bombay Legislative Council passed a resolution in July 1924 in favour of gradual restriction of liquor resulting in total prohibition in 20 years.

Fiscal interest of the State

This was then the position regarding excise policy on the advent of Provincial Autonomy. Since 1921 it can be said that the principle of prohibition has been accepted. The policy of the Government could not be changed mainly on financial grounds. Considering the fact that excise contributed about Rs. 15 crores to the provincial revenues, and Rs. 2 crores to

[1] C. N. Vakil, Financial Developments in Modern India, p. 480.

the Government of India by way of Customs duty during 1937-38, it is difficult to exaggerate the importance of this revenue in the finances of the country. It is one of the four major sources of revenue contributing an amount equal to the Income Tax, and is 12 per cent., of the total tax revenue of India. It occupies a position of varying importance in the provinces. In Bihar it contributes 30 per cent. of the total revenue against 25 per cent. in Bombay and Madras. At the other extreme it contributes 10 per cent. to the revenues of Bengal and even less in the Punjab.

Besides the financial consideration, the question was whether the enforcement of prohibition would not lead to illicit distillation. To make it successful the cost of enforcement was estimated to be heavy. The Prohibition Finance Committee of 1927 estimated the cost of the enforcement of prohibition in the Bombay Presidency at between Rs. 1½ to Rs. 2 crores of rupees.

Excise Revenue and the Individual

Let us also consider the position of the individual in relation to this tax. The payment is voluntary. Nobody is compelled to pay the duty on alcoholic drinks unless he chooses to consume such articles. It is not as if they were necessaries of life, which could not be omitted from one's budget without detriment to health or efficiency. Even then the element of taxation is there as it is a compulsory payment. As a tax it is very regressive in character. An intensive inquiry carried out in the Salem District (Madras) has disclosed the fact that the bulk of liquor excise was paid by 2 lakhs out of 25 lakhs of people (*i.e.* 8% of that district). Dr. Thomas concludes that this is perhaps true more or less of the other parts of Madras and may be largely true of other provinces also.[1] It has been estimated that of these labourers each addict spent Rs. 88 or 27·3 per cent. of his income on liquor.[2] Taking the cost

[1] Growth of Federal Finance, p. 450.
[2] P. J. Thomas, Economic Results of Prohibition in Salem, p. 6.

of liquor to be six times the revenue, each labourer might be considered to have contributed Rs. 15 to the provincial exchequer. According to the estimates of the Colwyn Committee and others, the proportion of income spent on drink was 15 or 16 per cent. in the U.K. Thus taking the class of people addicted to drink and the extent of the drink bill, it can be concluded that excise is heavily regressive in character.

Excise and the Community

We may consider in brief the relation of the community as a whole to this problem. That drunkenness has been held to cause disturbance in domestic peace is well-known. It produces loss of self-respect, neglect of duty, neglect of children and a general state which makes companionship impossible.[1] The relationship between drink and crime is found to be close. Temperance has therefore been advocated for the betterment of social conditions.

The investigations[2] carried out in Salem, the first district to be declared dry in India have borne out similar results. Family life has become healthier under prohibition. A fall in crime has also been found. The police crimes have fallen from a five years average of 938 per annum to 836 or a fall of 12 per cent., and private complaints have fallen from 653 to 501 or a fall of 23 per cent.

Conclusion

As a form of tax excise is thus open to serious objections. Though it yields a large revenue to the state, it benefits neither the individual nor the community. The view that taxation should be expressly designed for curbing noxious or other undesirable methods of consumption is not free from criticism, for if it is deemed necessary to check the consumption of a commodity there are more direct and effective ways of achiev-

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1 Report of the Royal Commission on Divorce p. 108.

2 See Dr. P. J. Thomas: Economic Results of Prohibition in Salem and C. J. Chari: Working of Prohibition in Salem.

ing that end. And one of the ways to make such people live better, is that temptation to drink must be abolished by the introduction of prohibition.

Introduction of Prohibition

In spite of opposition and difficulties, the Congress Governments are to be congratulated on their bold social experiment. The proposals to introduce Prohibition are under consideration in the Punjab and Sind, which are non-Congress provinces. This is a compliment to the efforts at social amelioration adopted by the Congress. The different Congress Governments have surrendered varying amounts of excise revenue. The question may be asked whether they will be able to finance the rest of the Prohibition programme. The task is indeed difficult. The financial sacrifice has already caused a heavy strain on the Provincial exchequer, and having a duty to discharge other obligations to the general public by way of liquidation of literacy and other reforms, it is difficult if not impossible to make both ends meet. The only hope has been a radical change in the financial relations of the Provinces and the Centre, by which the latter may release a larger share from Income Tax. In other federations excise is a federal subject, and therefore Prohibition would be a Federal liability.

No student of finance will question that in the long run the provinces will be able to make up for this loss through other sources of revenue. There is every possibility of an increase under the Entertainment Tax, the Tobacco Tax, and the Sales Tax consequent upon the release of purchasing power estimated at Rs. 15 crores in Madras.[1] But it will take some time for these effects to take place.

One will naturally question the wisdom of surrendering such a large amount of revenue which it can be said could have been put to a better use. In the case of an individual

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[1] Madras Budget Speech, 1939-40.

he will distribute his income in such a way that he gets the maximum benefit on the principle of marginal utility. On the same analogy the state also attempts to achieve the maximum benefit for the community. There are many items on the programme of national reconstruction such as liquidation of mass illiteracy and improvement of sanitary arrangements. Some argue that it would have been more conducive to social welfare if these had been taken up first. Economically and financially this attitude can be justified. But the Congress has introduced the moral aspect of the question by raising the issue whether it is wise to educate the children of the soil out of resources raised from drink. The Congress is equally strong in its efforts to remove illiteracy and to adopt other measures for social uplift, but perhaps its moral outlook in statecraft has not convinced all those parties to whom this outlook is novel or has resulted in some unexpected sacrifice.

Decline in Excise Revenue

Table VII in Appendix II will show the place excise revenue occupies in Provincial finances. No doubt every province which embarks on Prohibition will have to make heavy sacrifices. Bombay has been in advance of others in this respect. It has now to find 13 per cent. of the total revenue to complete its scheme of Prohibition. But in the case of other Provinces the percentage is still higher. The task of enforcement of Prohibition is entrusted to the Police Department. It is expected that this will be a cheap method. In the case of Bombay City, a sum of only Rs. 15 lakhs is provided as the cost of enforcement. In any case this cost will add to the financial difficulties of the Governments which adopt the policy of Prohibition.

We may point out that the Punjab, Madras and the C.P. have raised the price of exciseable articles in varying rates. Madras has raised the rates because many of the former addicts go to the neighbouring areas to drink. By raising the rates, the addicts are discouraged to cross the border of the prohibi-

tion area and thus the object is better served. On the other hand, such enhanced rates are expected to yield a larger revenue and thus compensate for the loss. The example of Madras is commendable and should serve as a guide to other provinces. The Punjab has raised the rates to those prevailing before the last depression and has thus increased its revenue by Rs. 2¼ lakhs.

Some economic consequences of Prohibition

Let us digress for a moment to consider the other consequences of Prohibition. The results may be immediate, short period or long period. The University of Madras as well as that of Annamalai carried out investigations about the economic results of prohibition in the district of Salem, the first to be declared dry in India. The conclusions are that among those addicted to drink, an alarming percentage of income was spent on drink. After the advent of the Prohibition era, the purchasing power so released is diverted to increased expenditure on food, clothing, entertainment etc. There has been repayment of debt,[1] and possibly regular payment of rent and taxes. It can be hoped that in part the state will be compensated for the loss on excise by the regular payment of taxes and increased receipts under entertainment duty, tobacco duty and sales tax. We are too near the event in Bombay and Ahmedabad, but when the effects of Prohibition in these cities are investigated, we may expect similar gratifying results.

Revenue from Stamps

The receipts under stamps are divided under judicial and non-judicial. The rate of judicial stamp duties is regulated by the Indian Court Fees Act 1870 as amended by the Provinces to suit their requirements. The duties are of the nature of fees—fees for the use of the services afforded by the courts of law. A question will naturally arise whether the court fees should be so fixed as just to cover the cost of the courts

[1] P. J. Thomas, Economic Results of Prohibition in Salem, p. 26.

or whether it is proper for the state to make a profit out of the services it renders. In many of the Indian Provinces the court fees pay more than the cost of the administration of justice. The official view is that "a vast amount of litigation in this country arises from complications of facts produced by the neglect of litigants themselves."[1] The higher duties are essential to prevent vexatious litigation. The popular view is inclined to consider heavy court fees as negation of justice.

Probate Duties

Another case covered by the Court Fees Act is of probate duties. In other countries the succession or estate duty is levied as a special tax. In India this has not yet been adopted, but in part the Government is compensated by duties on probates, letters of administration and succession certificates. The scope and rate varies from province to province, but it contributes a good amount to the provincial exchequer.

Commercial Stamp Duties

These are duties levied on commercial transactions under the Indian Stamp Act 1910 subject to provincial amendments to suit their requirements. The stamp duties do not themselves constitute a separate tax but are a method of collecting taxes of different kinds. Broadly the kinds of documents covered under the duties may be classed under three main heads :

1. Conveyance and other transfers of property.
2. Bonds, mortgage debentures and allied documents.
3. Bills of exchange and promissory notes.

Decline in Stamp Revenue

Table VIII in Appendix II will show the decline in revenue in different provinces in 1939-40 as compared with 1936-37. There has been a fall of about 1 crore of rupees in the interval. Some of the provinces have enhanced the rates

[1] Proceedings of the Council of Governor-General. 10th September 1869, p. 292.

during recent years, and this should have increased the revenue. The substantial fall in revenue is however due to the recession in world economic prosperity during 1939-40, as compared with the high peak of 1936-37, with its consequent effects on Indian business activity, and the contraction in litigation consequent upon the state measures for the relief of agricultural indebtedness.

Provincial situation re Stamp revenue

Madras: In Madras the fall in litigation which began in 1933-34 due to the measures for the relief of the agriculturists is still in operation. The Agricultural Debt Relief Act 1938 providing for the compulsory settlement of debt has accentuated the effects.

Bombay: In Bombay by an amendment of the Stamp Act dealing with the stock exchange transactions, the duty on agreements is doubled. The estimated yield from this measure is 6 lakhs of rupees and it is intended to extend the operation of the amendment to other forward markets. The taxation of the forward markets has been engaging the attention of the Governments for long. There has been a feeling in some quarters that it is undesirable to recognise these gambling transactions and to attempt to secure revenue from them. But the greater difficulty has been to devise ways and means to make rules effective and prevent evasion. In many cases the brokers' notes are unstamped or understamped and can never be brought to light. As was brought out in a recent case such frauds have been going on for the last twenty years. In the Bombay Stock Exchange, the settlements do not result in the delivery of transfers, nor is a blank transfer considered a bad delivery. The only alternative is to make the blank transfers void, but this is considered to be more drastic than the situation warants. During the year 1939-40 the fees on conveyance in urban areas was raised to produce two lakhs of rupees. The Government contemplates making the Court Fees Act applicable to the High Court to increase the revenue,

a reform recommended by the Taxation Inquiry Committee. In other provinces the proceedings before the Debt Settlement Board are exempt from stamp duties. The Bombay Agricultural Debt Relief Act does not extend this exemption as it is likely that the Government is not prepared to sacrifice any more revenue. In spite of this there is a fall in stamp revenue. The causes are the recession in economic activity and possibly the unwillingness of the parties to go to the courts due to costliness of litigation.[1]

Bengal: In Bengal the fall in revenue is due to the unsettled world conditions, the progressive establishment of debt settlement boards and the amending of the Tenancy Act abolishing Certificate proceedings.

The U.P.: In the United Provinces the stamp duties have been increased after a strenous opposition in a joint sitting of both the houses. In addition, the orders for the stay of judicial proceedings issued in connection with the legislation for the relief of indebtedness have ceased to be operative, and as such the revenue should have increased. But this is more than counter-balanced by the general causes mentioned above.

Bihar, the Central Provinces and Assam have raised the duties during these years at varying rates. But in spite of this there has been a fall due to the general causes mentioned above.

Principle factors in rate fixing

From this it will be obvious that the popular ministers have another difficulty to face. They will have to find a new source of revenue to fill in this gap. It may be emphasised that there has been a fall in spite of increase in rates. The principal factors in determining the rates are :

(1) The point of diminishing returns or what the traffic will bear;

[1] The Punjab Retrenchment and Resources Committee express a similar opinion. Report p. 91.

(2) The point at which the hardship on any class of community is involved.

It may be pointed out that the duty on bills in India is double that in England, and 5 times that in the United States, and that on bonds 4 times that in England and no less than 10 times that in the U.S.A. In spite of this, the rates have been recently increased accentuating the disparity.[1]

It can be concluded that the rates of judicial and non-judicial stamps have reached the point of diminishing returns. There may be a justification of the reduction of these rates. The loss can be made up by adjusting the probate duties. The existing duties discriminate in favour of race, religion and locality. The estate of all Mohammedans who die testate or intestate or estates of all Hindus who die intestate, and others not falling within the scope of the Hindu Wills Act, need pay no duty unless the parties themselves apply for and obtain probate or letters of administration. One way is to extend the operation of probate duties to all communities. Secondly, the duties can be graduated say from ½ per cent. to 10 per cent. with a possible exemption limit of Rs. 5,000. So long as inheritance taxes are not levied, there will be full justification for such adjustment.[2]

Stamp duties in the financial system

The system of levying duties on documents relating to transfer of property and commercial and other transactions has

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[1] Taxation Enquiry Committee Report p. 223. Rates of taxation in percentages.

		India	England	U.S.A.
Transfers	..	1	1	.10
Bonds	..	.5	.125	.05
Bills of exchange	..	.09	.05	.02

[2] The Punjab Retrenchment & Resources Committee has also recommended an increase in the rates of probate duties, graduating according to the amount of property so that when property exceeds Rs. 1 lakh, the rate applicable will be 5 per cent. instead of 3% at present. Report pp. 188-89.

been criticised by economists as unsound and serving no principle. Though these taxes may be proportioned to value, they are unequal as there is no uniformity in the frequency of transfer of property of equal value. In spite of this fact, they are popular with financiers because :

(1) They have the force of long custom;
(2) They are very convenient to collect and supervise;
(3) Their burden is not felt because they are collected in the process of circulation or distribution of property ;
(4) They facilitate proportioning taxation to value.

Stamp duties are therefore in general use in many countries.

Forest Revenue

The forest revenue is derived from the sale of timber and other forest produce and by fees for grazing. As such the receipts vary with the economic conditions in different provinces. For the purpose of administration the forests are divided into four classes as under :

(1) Forests the preservation of which is essential on climatic or physical grounds ;
(2) Forests which afford a supply of valuable timber for commercial purposes;
(3) Minor forests;
(4) Pasture lands.

In considering Dr. Voelkar's report on Indian Agriculture, the Government of India declared that "the sole object with which the State forests are administered is the public benefit."[1] In order to carry out this object the forest policy aims at giving reasonable facilities to the public for the use of forest produce on the one hand and preserving the forest "as sources of fuel and timber and as agencies by means of which rainfall may be stored in the soil and given off subsequently by gentle flow."[2]

[1] Cf. C. N. Vakil, Financial Developments in Modern India, p. 503.
[2] Cf. Ibid.

The figures in Table IX in Appendix II will show the results of the working of the Forest Department. It is treated as a commercial department and the interest on capital outlay on forests is charged to it. As such we shall be justified in taking the net surplus as the result of the working of the department.

In spite of a large area covered under forest the gross receipts of all the Provinces was only Rs. 2·5 crores, while the net contribution was only Rs. 66 lakhs in 1936-37. After the advent of the Congress Governments there was a change of forest policy in certain provinces. From the year 1938-39 the Government of Madras granted a reduction in the grazing fees by half at the cost of Rs. 3 lakhs. In the very first year of the Congress Government in Bombay, the entire grazing fees were abolished at the cost of Rs. 5 lakhs. The C.P. Government has also reduced the grazing fees at the cost of Rs. 1 lakh. In spite of these concessions the gross receipts were higher by about Rs. 10 lakhs due to better utilisation of the forest produce. But the net receipts had fallen by Rs. 4 lakhs in 1939-40 as a larger amount was spent on forest preservation.

From the table it will be clear that in all cases a large part of the revenue is spent on conservation and preservation of forests for which a large establishment is maintained. Because of this the Forest Department worked at a loss like other commercial departments during the last depression as there was a sudden fall in income.

In spite of such expenditure, the Industrial Commission has found that an incomplete use has been made of forest resources, that industries dependent on forest produce have not been developed, and that the necessary link between forest research and commercial exploitation of forest produce is wanting. Although the match, wood pulp and paper industries have been developed recently, it is obvious that the potentialities of the forest wealth are much greater, and await proper exploitation.

Registration Fees

Table X in Appendix II will show the net revenue from this head during 1939-40. It includes sums collected for the registration of documents. Certain types of documents require compulsory registration while for the others it is optional. The services rendered in return for these payments are the maintenance of a correct public record of all documents requiring compulsory registration and the giving of a probative value to others. Because of the large establishment for this, the expenditure is heavy. The element of taxation is very little and need not detain us. The fees are determined by executive order and have been increased from time to time.

CHAPTER V

NEW SOURCES OF REVENUE

In the last chapter we reviewed the position of old sources of revenue which the Provinces had before 1937. We shall now discuss the new sources of revenue, which the Provinces have obtained as a result of the Act of 1935 or new taxes which they have recently imposed under the powers obtained by them under the same Act.[1]

These new sources of Provincial Revenue may be grouped as under :

1. A share of the Customs Duties.
2. Income Tax :
   - (a) a share of the General Income Tax,
   - (b) Agricultural Income Tax.
3. Taxation of Motor Vehicles.
4. Taxation of amusements.
5. Sales Tax :
   - (a) general.
   - (b) selective :
     - (1) motor spirit and lubricants ;
     - (ii) tobacco ;
     - (iii) electricity ;
     - (iv) cloth, silk yarn, silk and artificial silk ;
     - (v) wireless sets, motor cars, motor cycles.
6. Employment Tax.
7. Property Tax.
8. Miscellaneous Taxes :
   - (a) Tax on prize competitions.
   - (b) Sugar Cess.
   - (c) Tax on aerated waters.

[1] In the classification that follows, there are some sources of revenue which are grouped under New Sources, though they were in existence in a few provinces before 1937. Their role was however insignificant at the time, and they have been really developed in more recent times in most of the Provinces.

Share of Customs

Under the settlement of 1921 Bengal had recurrent deficits. By the end of 1933-34 the net deficit debt had accumulated to Rs. 7.5 crores, debt charges on which came to Rs. 57 lakhs during 1934-35. Such was the situation of Bengal after having levied taxation of Rs. 1.5 crores and having reduced other charges by Rs. 50 lakhs. The Central Government being convinced that Bengal had done all that was practicable, and finding her debt to the Centre unmanageable, decided as an interim measure of relief, pending the advent of a fresh settlement under the new constitution to give her 50 per cent. of the jute export duties on jute grown within the province from 1934-35. Incidentally this measure benefited the other jute growing provinces like Bihar, Assam and Orissa. The receipts of Bengal alone came to more than Rs. 5 crores during 1934-37 while the other provinces benefited by about Rs. 55 lakhs.

Sir Otto Niemeyer reviewed the position and made a recommendation to increase the share of the jute export duty to the provinces concerned to 62½ per cent. This has been accepted. The average net revenue per annum for Bengal came to Rs. 230 lakhs during the first three years of Provincial Autonomy.

The grant of this share of duty raises fundamental issues for a student of federal finance. Under every scheme of federal finance hitherto known the Customs Duty is a federal source of revenue. In our case there is a definite departure from this principle. The argument advanced in support of the departure is that the commodity being a monopoly, the incidence of the tax does not fall on the Indian producers nor does it fall on Indian consumers. But this departure has led another province to make a similar demand. Assam has been claiming a share of the excise duty on kerosene and petrol. So far the demand has been rejected on the ground that the

incidence is borne by the residents of the other parts of the country.

Income Tax

This item includes a share from the General Income Tax collected by the Centre and the receipts from the Provincial Tax on agricultural incomes. We have already discussed the basis of the distribution of the General Income Tax and the following table[1] will show the receipts on this account :

	1937-39 Accounts.	1938-39 R.E.	1939-40 B.E.
		(In lakhs of Rs.)	
Collection of divisible Income Tax .. .	11,87	12,07	12,65
Contribution from the railways	2,76	2,05	2,13
Total . ..	14,63	14,12	14,78
Deduct : amount to be retained by the Centre ..	13,00	13,00	13,00
Balance available for the Provinces ..	1,63	1,12	1,78

The distribution of the income tax has been made dependent upon the working of the railways the finances of which have been in a precarious position since 1931-32. The unpaid contribution of the railways to the general revenues amount to Rs. 37 crores by the end of 1939-40.

As the Depreciation Fund of the Railways has assumed importance a brief reference to it will be useful. In 1924-25 a Depreciation Fund was started to provide for the cost of renewing and replacing all wasting assets. Each year in proportion to the depreciation in the value of the assets a sum is set aside for replacing it in due course. Since 1935-36 the amount set aside annually to cover depreciation is one-sixtieth

[1] The details of the share of each province will be found in Table I in Appendix II.

of the capital outlay. The new method was adopted to simplify the procedure though the annual allotment came to the same under both the systems, about Rs. 12 crores. The expenditure came to Rs. 8 crores leaving a balance of Rs. 4 crores to augment the fund. It would have amounted to Rs. 61 crores but for the fact that during 1931-36 loans were taken from the fund to meet interest charges. It was however laid down that any surplus thereafter should be utilised in payment of these loans. But since 1937, in order that the Central Government may be able to release some share of Income Tax to the Provinces, this arrangement was suspended for a period of three years at first and then upto 1942. By the end of 1940, the outstanding amount of loans to the Railways will be Rs. 30 crores and Rs. 31 crores will be held in the Depreciation Fund. In view of this a suggestion has been made to write off the above loans and to revise the principle of allotment to these loans so that it may conform more to the actual requirements, and simultaneously reduce the charges on the receipts of the railways.

Since the beginning of 1939, the Income Tax administration has been overhauled. Many of the exemptions have been withdrawn, and the "Slab" system of taxation has been introduced in place of the "Step" system. The machinery has been tightened up to prevent evasion. The changes are beneficial to the lower income groups. But the loss on this account will be more than compensated by higher rates for the upper groups with the result that the revenues are expected to be higher by Rs. 66 lakhs. Besides, the Centre is gaining a larger revenue by the taxation of corporations.

The war is likely to increase the provincial share of income tax. The railway returns are showing a rise and if this tendency persists, there is every likelihood of an increased contribution. The trade conditions are also prosperous as can be seen from the increase in the volume of currency and credit and other indices.

Agricultural Income Tax

One important source recently tapped is a tax on agricultural incomes levied in Bihar and Assam. The taxation of this income is under contemplation in Bombay and very likely Bengal will adopt it after the Land Revenue Inquiry Committee has submitted its report. This source will ease the embarrassment of the Finance Ministers. In Bihar the estimated yield is Rs. 30 lakhs. In Assam the yield is placed at Rs. 25 lakhs. Sir Walter Layton placed the yield at Rs. 5 crores for British India.[1] It will be a welcome addition to the meagre Provincial revenues. We have already suggested this tax along with our proposals for a reform of the Land Revenue system.

In view of the recent discussions on the subject, a brief review of the problem will be useful. The question of taxing the income from land arose in 1860. The period 1859-64 was one of great financial difficulty consequent upon the huge expenditure incurred in suppressing the mutiny. All sources of revenue were explored. Taxes on income were proposed and the question arose whether the Government could include the income from agriculture in view of the regulation fixing the revenue demands from land in perpetuity. Sir James Wilson while supporting the inclusion of income from land said, "I hold him (the zamindar) to be exempt from any special charges upon his land but to be liable to any general tax that applies to all others."[2] The income from land continued to be taxed on each successive occasion. It was only at the time of passing the Act of 1886 that this income was exempted. But it is essential to distinguish between the conditions. After the famine of 1877-78 cesses were levied on lands in Bengal. Under the Consolidated Act of 1880, half of the proceeds were shared by the local bodies for public works. This arrangement continued till 1913-14, when pur-

1 Indian Statutory Report Vol. II, p. 257.
2 Proceedings of the Council of Governor General, Feb. 18, 1860.

suant to the recommendations of the Decentralisation Commission, the whole of the proceeds were handed over to the local bodies.[1] The income from land continued to be exempted in subsequent Income Tax Acts. Thus the exemption of this income from the General Income Tax, earned under special circumstances mentioned above, is a feature peculiar to India.

On grounds of equity of taxation, it has been pointed out that the taxation of income from land will cause hardship to smaller landlords, specially those having uneconomic holdings. The objection can be removed by prescribing taxation limits sufficiently high. The Indian Taxation Enquiry Committee supported the proposal on the ground that land revenue has been amortised. Landlords in most of the cases neither cultivate land, nor pay land revenue. They were of the opinion that when a person investing in shares and securities has to pay income tax, there is no reason why a man investing in land should be exempted. It may also be pointed out that in western countries income from land bears a higher percentage of tax than other incomes. For example, in France and Italy such income pays ten per cent. more than the general income tax. In view of this, we suggest that the exemption limit should be fixed in accordance with the incidence of land revenue in each province — a higher limit in the temporarily settled districts and a lower one in the permanently settled ones.

If a scheme is devised as above, will the yield be adequate to justify taxation ? In Bihar, as mentioned before, the yield is estimated at Rs. 30 lakhs while in Assam the figure is Rs. 25 lakhs. It will be obvious that in the major provinces the yield will be adequate if not substantial.

Administratively the tax will be economical though it is true that the various grades of tenants, rent receivers and the

1 Para 773.

ryots do not keep accounts at all. In western countries this difficulty has been overcome by assessing income to bear a certain relation to rent. The system can be conveniently adopted subject to local variation, if any.

Bihar was the first province to levy a tax on agricultural income in 1938. There were strong political difficulties and the original bill had to be modified substantially. The landlords considered themselves free from this tax and there was a strong opposition from them. Under the scheme as adopted by the Legislature, incomes below Rs. 5,000 are exempted. Those between Rs. 5,000 and Rs. 10,000 have to pay at the rate of 6 pies in the rupee, and the rate rises up to 30 pies in the rupee if the income exceeds Rs. 15 lakhs. The scheme of the Act is similar to the Indian Income Tax Act as it was before the recent amendment. The principle of progression is definitely accepted. The administrative machinery is also similar.

Assam also passed such a measure in 1939. The income from plantations under the Indian Income Tax Act was divided into that from manufacture and that from land. The division was arbitrary, and it benefited the planters by exempting a part of their income. This anomaly has been rectified recently. The rate of tax on agricultural income from an individual, a Hindu undivided family and a company is to be prescribed in the Annual Finance Acts of the Province but will not be higher than the Central Income Tax rates. There will be no super tax and income below Rs. 3,000 is exempted. A sum of Rs. 25 lakhs is expected from this measure.

The rates of tax prescribed from the year 1939-40 are as follows :

(1) In the case of an individual, firm and other associations :

(a) On the first Rs. 1,500 of total income .. nil.

(b)	On the next Rs. 3,500 of total income ..	9 pies in 1 Re.
(c)	On the next Rs. 5,000 total income .	15 pies in 1 Re.
(d)	On the next Rs. 5,000 of total income ..	24 pies in 1 Re.
(e)	On the balance of the income ..	30 pies in 1 Re.

In the case of a company the rate will be 30 pies in the rupee for the entire income. But in any of the above cases the tax will not be levied on the first Rs. 3,000 and further in no case will the tax exceed half the amount by which the total agricultural income exceeds Rs. 3,000.

It will be obvious that in the case of an individual the rates are the same as for the Central Income Tax except that there is no super-tax. In the case of a company, the Central Government rate is 1 anna in the rupee against 2 as. 6 ps. in Assam.

Provincial Taxation of Motor Vehicles

Since 1924 the provinces have passed legislation for the taxation of motor vehicles. The general principles of taxation of Motor Vehicles Acts are to withdraw the power of the Local Boards to tax vehicles and take tolls on bridges. The Provincial Government collects the tax on a uniform basis throughout the district, and then makes grants out of it to the local boards by way of compensation after deducting the incidental charges of collection. The compensation is based on the average of the three years previous to the coming into force of the Act. As such it is a fixed charge and the surplus goes to the provincial revenues. For the year 1939-40 the compensation comes to Rs. 71 lakhs in Madras, Rs. 7.5 lakhs in Bombay and Rs. 4·5 lakhs in Bengal. The surplus is utilised for general provincial roads except in the case of Bombay and the U.P.

Under Section 9(4) of the Bombay Motor Vehicles Tax Act 1935, if the net proceeds of the tax in any year exceeds the sum of Rs. 26·57 lakhs, the surplus is transferred to the Provincial Road Fund which can be expended on the construction, improvement and maintenance of new and existing roads. In the U.P. the sum to be transferred to such a fund for similar objects is Rs. 10 lakhs. Due to increase in motor transport the yield from this source is growing.

Taxation of Amusements[1]

(*a*) *Entertainment Tax.* The taxation of entertainment in recent years has become popular in many countries. In Canada, several provinces levy taxes on admission to places of amusement. In the U.S.A. many states have utilised this source to augment their revenues. It is levied in Great Britain as well as in many other countries. Bengal was the first province in India to utilise this tax in 1922. Bombay imposed it in 1923 and it is in force in Sind also. It was levied in the Punjab during 1936-37. It has been levied in the U.P., the C.P., Bihar and the N.W.F.P. during 1937-38. In Madras it was a local source of revenue ; but in 1939 it was provincialised and the local bodies were compensated for the loss. In Assam it was levied in 1939-40.

The rate of the tax in Bengal is 6 pies when the value of admission to the place of entertainment is 3 annas and thereafter it is graduated. The average rate works out at 12½ per cent. Admission below annas 3 is exempted. In Bombay if the admission rate is annas 4 or less it is exempted from the tax. The rate is graduated according to the value of admission and works out at 12½ per cent. In Madras there is no exemption limit. The rate begins with 3 pies when the value of admission is annas 2 or less and thereafter is graduated. It works out at about 15 per cent.

[1] The receipts of the different provinces will be found in Table XI in Appendix II.

The Entertainment Tax is a tax on expenditure, but being a tax on luxury, there is much to be said in favour of it where it is productive. In all the provinces it has been possible to realise a large revenue at a small cost. This has been achieved by controlling the business. The proprietors of the places of entertainment have to take out licences from the police who are also in charge of administering this tax. As such it has been an administrative success.

The tax has been opposed on the ground that it is on expenditure and is therefore regressive. This has been mitigated by exempting the lower values and graduating the higher. The tax has also been objected to as it is a tax on amusement and recreation which is essential to the well-being of the community. But if this discourages expenditure, it stimulates savings which is also essential. This form of taxation can be fully justified under present conditions when large losses are incurred under Stamps due to the adoption of the measures for the relief of rural indebtedness, and a large revenue is being surrendered under Excise, and large reductions in the Land Revenue demand may have to be made if the system is reorganised.

(*b*) *The Taxation of betting*. Betting is a common source of income in other countries. It has been levied in Bombay since 1925 and in Bengal since 1932. It has been recently levied in the U.P., Madras and Assam. So far it was limited to horse racing but recently dog racing has been included in Bengal. In Bombay and Bengal the rate is 4 per cent. on the monies staked in the totalizator and with the licensed bookmakers. The tax is objected to on the ground that it legalises gambling.

Sales Tax

Sales tax, though developed recently has assumed phenomenal importance. It has been adopted by a large number of countries and has become a major source of revenue in some. In view of the decision of the Federal Court in

favour of sales taxation, it is hoped that this tax will bridge the widening gap in provincial finance between the drying older taxes and expanding new services. Among the new sources there are few which can give such large yields as sales tax.

Most of the provinces have by now introduced Sales Tax in their tax system, and it bids fair to compete with older ones in importance. In view of this we have discussed the principles and problems of this tax, in Appendix I, and shall refer here briefly to the growth of general and selective sales taxation in the provinces.

I. General Sales Tax

During 1939 a turnover tax was levied by the Government of Madras with a view to permanently augment its resources. It is estimated to yield Rs. 12 lakhs in 1939-40 and about Rs. 25 lakhs thereafter. It includes the sale of tangible commodities only. Turnover has been defined as the aggregate amount for which goods are either bought or sold for any valuable consideration. Most transactions are taxable except a few. To mitigate the regressiveness, the sale of agricultural produce of a farmer grown on his land is exempted. In consonance with the general principles to prevent double taxation, the sales of articles like motor spirit, tobacco, etc. which are specially taxed are exempted. The sale of bullion, specie, cotton, cotton yarn, or any cloth woven on hand-looms and sold by persons exclusively dealing in such cloth is also exempted. Finally to prevent pyramiding effects it is provided that both the buyer and the seller shall not be taxed in respect of the same transaction but only one of them as determined by rules. This clause is likely to introduce administrative difficulties.

Under the Act, every dealer has to take out licences, to maintain proper accounts and submit periodic returns. To prevent the diversion of trade to neighbouring states, it is provided that a rebate of half of the tax paid in respect of

certain manufactures notified by the Government shall be granted on the goods actually sent out of the province. Dealers whose turnover exceeds Rs. 20,000 per annum are liable to pay the tax at one-half of one per cent. of such turnover or one pie in the rupee. Those whose turnover does not exceed Rs. 10,000 per annum are exempt from taxation. Those having turnover between Rs. 10,000 and Rs. 20,000 have to pay at the flat rate of Rs. 5 per annum.

This is the first effort to levy the turnover tax. It is too early to judge its economic consequences such as the integration of industries, the substitution of brokers, pyramiding effects and regressiveness. Although this is the first venture, its lessons will be useful to other provinces.

II. Selective Sales Tax

The following commodities have been selected for sales taxation in different provinces :

1. Motor spirit and lubricants.
2. Tobacco.
3. Electricity.
4. Cloth, silk yarn, silk and artificial silk.
5. Motor cars, motor cycles and radio or wireless sets.

(1) Sales Tax on Motor Spirit

Sales tax on motor spirit has been levied in Madras, Bombay, the U.P., the Punjab, Bihar, the C.P., Assam, Sind, and the N.W.F.P. In C.P. and Assam the tax is levied on motor lubricants also. The rate on motor spirit varies from 1 anna per gallon in Bombay to 2 annas in the U.P. and the Punjab. The rate on lubricants varies from 8 per cent. in the C.P. to 3 annas in Assam. The estimated yield for all the provinces will be about Rs. 40 lakhs. The tax will not cause administrative difficulties as the dealings are already well regulated. The tax can be easily justified as it will be borne by those who can afford to pay.

(2) Taxation of Tobacco

Tobacco is one of the commonest articles taxed internally in most countries. In France and Italy it is taxed by the creation of a monopoly. In other countries an excise tax is levied on tobacco. In parts of Madras (Coimbatore, Malabar and South Kanara) country tobacco was a state monopoly and cultivation was not allowed except under a licence during 1811-1858. The taxation of tobacco has been under consideration since 1859 in our country. It was recommended by the Taxation Enquiry Committee of 1924.[1] But the difficulties are that the conditions under which tobacco is produced and passes to the consumption stage are wholly unregulated in our country.

Madras made a systematic attempt to tax this source of revenue in 1939. In order to concentrate dealings, the Act forbids the sale of tobacco without a licence. The Act classifies the dealers into retailers, wholesalers in manufactured tobacco, and wholesalers in unmanufactured tobacco. The retailer is taxed at the rate of 3 per cent. on the turnover up to Rs. 400 and 10 per cent. on any excess over Rs. 400. The wholesaler in manufactured tobacco has to pay at the rate of 2 per cent. on the turnover, while the wholesaler in manufactured tobacco is charged a licence fee from Rs. 50 to Rs. 100 varying with the turnover.

From this the complexity of the Act will be obvious. It classifies the dealers and attempts to tax them at varying rates. There are no exemptions and the transactions are taxed at more than one stage. The incidence of cumulative taxation will thus be heavy.

In Bombay City the sale of tobacco without a licence is prohibited under the Tobacco Duty Act, 1857. The licence fee has been raised since 1938 from Re. 1 to Rs. 25 or Rs. 50

[1] The Punjab Retrenchment and Resources Committee has also supported the taxation of tobacco at 10 per cent. *ad valorem*. Report p. 217.

according to the quality of the tobacco. In addition, a duty of Rs. 30 per maund is levied on tobacco imported into the town. The revenue has been handed over to the Municipality, but it has always been recognised as a state contribution to Municipal funds to finance the deficits of the Improvement Trust and can be withheld at any time—a right which has recently been exercised. The Government of Bombay henceforward will pay only two-thirds of the net proceeds of the Tobacco taxation or Rs. 10 lakhs whichever is less to the Municipality, consequent upon the diminution of the deficits of the Improvement Trust Budget averaging at about the same figure.

In the Province outside the City, the sale of tobacco, without a licence is prohibited under the District Tobacco Act, 1933. An *ad valorem* licence fee was charged to the retailers, but as they did not keep accounts it was difficult to assess the fees. In 1938 the Act was amended in two respects: (1) a flat rate of licence fee is now charged to the retailers and the consequent loss is expected to be balanced by a higher rate of fee on the wholesalers; (2) the Act provides for levying a tax on sales up to 50 per cent. *ad valorem* in specified urban areas where efficient arrangements can be made to prevent evasion. The whole of the proceeds of this tax are credited to the provincial funds and nothing is granted to any of the municipalities or the local boards.

The Government of the C.P. have also recently levied a tax on the sales of tobacco. Except in the case of the grower any sale or possession of tobacco without a licence is prohibited. The licence fee for the retailers varies from Rs. 2 to Rs. 50 per annum according to the population of the village or the town. The licence fee for the wholesalers as well as the manufacturers and wholesalers is Rs. 100 per annum. A tax at a rate to be prescribed by the Government but not exceeding 10% is to be levied on all sales other than those of a hawker. But the tax on the wholesale sales and a tax on retail sales will not be in

existence in any area at the same time. The idea seems to be to avoid double taxation. The measure is estimated to yield Rs. 4½ lakhs.

(3) Taxation of Electricity

A duty on electricity has been levied in Bombay since 1932, in Bengal since 1935, and in Madras since 1939. When it was first levied in Bombay, the rate was 6 pies per unit of electricity consumed for domestic purposes of lighting and fan. The consumption by industrial establishments as a source of power and the consumption by railways and tramways is exempted. The rate was raised to 9 pies in 1938-39 and 15 pies in 1939. In each case the increased duties have been counterbalanced by a corresponding decrease in the charges for electricity. Industrial consumers are benefited by the reduction in tariffs as they are exempt from taxation. Their gain is estimated at about four lakhs per annum. In Bengal the rate is 6 pies, the other conditions being the same as in Bombay. In Madras the producers selling 2 lakhs units or more at the rate of 2 annas or more, have to pay a duty at the rate of 6 pies per unit of energy sold.

The tax on electricity cannot be easily justified.[1] It has become a necessity and enters in the family budgets of all classes of people, including the poor. The tax has proved highly productive as the licensees for the sale of electricity have to collect the tax and remit it to the government. It can be said to be convenient as it is paid in small doses. But it fails to satisfy the principle of ability to pay. Being a tax on expenditure it is highly regressive. In Bengal the small consumers are exempted, but in Bombay that exemption has been withdrawn since 1939. The incidence of the tax is also heavy in Bombay, where it is levied at the rate of 15 pies on consumption worth 2 annas, which works out at 62½ per cent.

[1] The Punjab Resources and Retrenchment Committee has recommended the tax at 6 pies per unit on the grounds of adequacy. Report p. 228.

The Finance Minister defended the increase in the rate in each case on the ground that the consumers would not have to pay anything extra. But the only result is that what was rightly belonging to the consumers by way of reduced charges, has now been appropriated by the Government. The method of taxation in Madras is still less justifiable. The consumers supplied by companies selling less than 2 lakhs per annum will be exempted from the tax, while consumers in all other cases will have to bear the burden. It will hit the industries also. If the intention was to tax the companies it can be pointed out that it will very soon be defeated. An indirect tax is shifted to the consumers in the long run and the same will be the case with this tax also.

(4) Taxation of Cloth

We shall now consider the taxation of sales of manufactured cloth excluding the hand-made cloth, artificial silk and silk yarn. The Government of Bombay passed an enabling Act in 1939, and intended to impose the tax after working out administrative details. The Act made licences necessary for dealings in cloth and the tax was to be levied at only one transaction and the rate was 6¼ per cent. on the volume of sales. The dealers were to maintain regular accounts and submit periodical returns as required by the Government. The Government could not work out the necessary details, as they were faced with the problem of licensing and assessing innumerable petty dealers in the interior, which was bound to lead to trouble and cost. Besides the difficulty of differentiating sale for consumption from that for resale with a view to prevent double taxation as well as evasion was great.[1] The greatest obstacle was the lack of requisite information and with a view to obtain the same, the part of the Act making

[1] This difficulty was foreseen by us in our article on the subject published in the Commerce on 25-2-1939, p. 301, for which see Appendix I.

licenses necessary for the sale of cloth was enforced from 1st July 1939.

In the process of issuing these licences the Government have been able to collect valuable data. They have found that there are about 4,000 wholesale dealers and 20,000 retailers in the Province. On the basis of these returns it has been estimated by Government that the average annual turnover of a wholesale dealer is Rs. 5 lakhs and that of a retailer Rs. 65,000. Thus the total turnover of the retailers comes to Rs. 130 crores. Even if they alone were taxed the yield would have exceeded Rs. 8 crores against the estimated figure of Rs. 25 lakhs. It is obvious that a large part of the trade is concerned with distribution.

In view of this it was not clear as to where the levy should begin and where it should end; whether it was at the first sale or the second sale or at the time of actual use. Besides an elaborate staff for inspection seemed to be necessary for such a large number of petty traders some of whom might be illiterate. The tax would thus be both irksome to the tax-payer and expensive to the Government. In view of these difficulties the Governor who has taken over the administration since the political deadlock has decided not to proceed with the sales tax on cloth.

(5) Sales Tax on Articles of Luxury

Assam has levied sales tax on three articles of luxury, *viz.* motor cars, motor cycles and radios and wireless sets at a low rate of 5 per cent. The tax is to be levied on retail sales only. The tax can be easily evaded as it is not difficult to bring these articles from neighbouring places where they are not taxed. In the American States where such an evasion was found, the situation was remedied by the levy of an "use tax" for the use or the possession of the taxed article.

Conclusion and suggestions

Though it has been in operation only for a short time, the yield from the sales tax for all Provinces is estimated at Rs. 1·5

crores in 1939-40 and Rs. 2 crores in subsequent years on the basis of the existing legislation. Thus it satisfies the requirements of adequacy inasmuch as it has made it possible to raise a large revenue at a small cost. The doubts about its administrative success have also been removed. The Government have compelled the dealers to take out licences, to maintain regular accounts and submit periodic returns.

It is opposed because it is regressive in character. But it should be realised that the commodities selected so far mostly affect the rich, and that under our conditions the sales tax replaces excise which is more regressive in character. Thus it can be concluded that the sales tax mitigates to some extent the general regressive character of our tax structure.

Employment Tax

Some of the provinces have levied taxes on employment, trade or calling. The Employment Tax resembles the poll tax or capitation taxes and the *thathemeda* of Burma so far as the basis of taxation is concerned. On the other hand it is compensatory to income tax as a flat rate tax of some importance which may counterbalance income tax evasion by individuals.

Poll, capitation or head taxes are of ancient origin. It was the earliest form of direct taxation. Each adult member of the family had to pay a contribution per head. It is yet to be found in many countries, but nowhere does it form a substantial portion of public revenues. Although it is a direct tax, it does not take account of ability to pay, and therefore, it is open to objections.

In India, a tax on professions and employments was levied under the name of licence taxes in 1859. The assessees were divided into 10 classes and the tax varied from Rs. 2 on incomes of Rs. 500, to Rs. 2,000 on the class with the highest income. The military and civil officers were also made to pay at the rate of 3 per cent. of their salaries. The Act was repealed in 1862. But the licence taxes were revived from

time to time whenever there was financial stringency. In 1871 it was assigned to Provinces under Lord Mayo's scheme of financial settlement. The Provinces levied them from time to time according to their requirements.

Under the new constitution, this source has been assigned to the Provinces and the Central Provinces was the first to utilise this to augment its revenues. A tax at the rate of Rs. 28 per annum is levied on all the persons paying income tax, since 1937-38. Those below the taxable minimum for the income tax are exempted. The tax is payable in quarterly instalments. It is estimated to yield Rs. 2.25 lakhs. A tax on Professions was levied in Bengal in 1939. The scheme of the tax is similar to that of the C.P. except that the rate is Rs. 30. It is expected to yield Rs. 12 lakhs.

The U. P. Employment Tax proposed in 1939 created a controversy. The whole scheme of this tax differed from that found elsewhere. The basis of the tax was service of any kind with the public and semi-public authorities, excluding the defence services, or service of a company or a person. For the purpose of taxation, the directors and the agents or corporations were considered employees. The Act did not apply to professional persons and businessmen. It was restricted to salaried persons other than those in the Army, the Navy and the Air Force. The principle of origin as well as of residence was applied in computing income. Salaries below Rs. 2,500 per annum were exempted. The assessees were classified in income groups, and a flat rate of tax was prescribed for each group. The first group consisted of assessees having an income between Rs. 2,500-3,000 per year. The rate worked out at 10 per cent. on higher income groups.

This measure caused great controversy and the bill was reserved for the consideration of the Governor-General. The Central Government felt that "if a province held the unlimited power under the Act to impose taxes of this nature, the taxable capacity in the Central field could be seriously

qualified". With a view to put this question beyond a shadow of doubt, but at the same time to provide an equal opportunity to Provincial Governments, Parliament has recently amended the Act. It is now provided that Employment Tax will be definitely *intra vires* in the Provincial sphere up to a certain maximum limit namely Rs. 50 per annum, even if the basis of taxation is income. At the same time the Governor-General has decided to suspend the consideration of the United Provinces Employment Tax Bill. It was obvious that the Governor-General was not sure about its invalidity. But instead of getting it judicially interpreted, the Parliament has thought it wise to step in and safeguard the interests of the Centre. This action reaffirms the theory that the security of the Centre has been the main principle in determining the financial settlements under the present Act.

Subject to the limitation mentioned above however, an Employment Tax can be levied by a Province. It may be noted that the machinery and method of assessment is similar to that of the Income Tax. The collection of the tax is at the source. Both employees and employers are required to submit the prescribed returns.

The Employment Tax is a direct tax, but lacks the principle of progression. Though it is regressive in its effect, this is mitigated under the schemes in force in the Provinces, which exempt the lower incomes. The administration is economical and the tax being payable in instalments, it is also convenient to tax payers. Lord Stamp considers that a light poll tax is not unsuited to Indian conditions.[1] The tax can be utilised in other provinces to counterbalance the regressiveness of the sales tax. In Bombay with 70,000 income tax payers the yield of such a tax if imposed is likely to be substantial.

[1] I.T.E. Report Vol. II p. 8. The Tax has also been recommended by the Punjab Resources and Retrenchment Committee, 1939, p. 222.

Property Tax

Another important tax which has been levied is the Urban Immovable Property Tax imposed in 1939 in Bombay City and Ahmedabad. It is levied at 10 per cent. of the rental value. Properties yielding less than Rs. 2,000 per annum as rental in Bombay have to pay at the rate of 5 per cent. With a view to compensate trust properties for the loss of income, it has been recently decided to grant a rebate equal to the tax paid.

Historically the property tax has been well nigh universal. It was one of the earliest forms of direct taxation. The difference has been in the nature and the base of the tax and assignment of the yield. In America the entire property, tangible, intangible, movable as well as immovable is subject to taxation. In England and other countries the tax is on immovable property only. In the United States, it is a local source of revenue. But the states have the right to levy surcharges for their own use. In England till the Inhabited House Duty was abolished in 1924-25 the tax was found to be a convenient mode of assessment. Probably on account of the difficulty of obtaining actual rents, recourse was had to taxing hearths and windows. This tax was a permanent direct tax upon the occupants of dwelling houses based on the annual letting value. It is now retained as a source of local revenue. In other countries also it has remained a local source of revenue.

In Bombay and Ahmedabad the local bodies already levy the property tax. The Provincial Government has levied the tax on the same. It has been doubted whether it was proper for the Government to encroach upon the local field of taxation. It is obvious that the recent taxation has reduced the potential resources of the two local bodies which are responsible for the civic amenities of the cities under their care.

Property taxes are justified generally on the ground of benefits received from the state by way of protection as well as ability to pay. The ownership of property implies the exis-

tence of tax paying capacity, and the larger the ownership the greater is the tax paying capacity. Property taxes are therefore regarded as one of the means in distributing the cost of Government in proportion to ability to pay. To achieve this the property taxes are levied at progressive rates which is not possible in India because of constitutional limitations.

As a form of taxation, the property tax will meet with general approval. As the local bodies are entrusted with the work of collecting the tax along with their own dues, it will be economical. As the tax is to be paid in instalments it will be convenient also. Although it is a direct tax it lacks progression and as such will be regressive in certain groups. In England it was abolished because it was considered as an unnecessary and irritating addition to the burdens of large sections of the working classes. The Bombay Act attempts to prevent this by making illegal the shifting of this tax to those paying less than Rs. 80 per month as rent. It is questionable whether this is practicable in the long run. The tax will be open to objection, if we examine its effects on the community. At present the community is dependent upon private agencies for housing accommodation. The private agencies will undertake the work, only if they get a fair return. During recent years there was a housing boom consequent upon the low rate of interest and absence of other avenues of investment. Even then the supply has not kept pace with the demand. The population of the cities have increased in greater proportion to the housing facilities available. With reduction in the yield on properties due to the tax and the rising rate of interest, it is probable that there will be a slump in housing construction. If this be so, the housing problem will become more acute.

Miscellaneous Taxes

A tax at the rate of 12½ per cent. is levied in Bombay on prize competitions. A sum of five lakhs is expected to be realised form this. Many prize schemes have been promoted

in the presidency during recent years. It will neither be administratively difficult nor inconvenient to payers. As such the taxation is fully justified. A bill has been moved in the Legislative Assembly of the N.W.F.P. proposing a tax of 3 pies per bottle of aerated waters. Aerated water was recommended for taxation by the Indian Taxation Enquiry Committee fifteen years ago. The N.W.F.P. is the first province to implement the recommendation. Being a small province with a few urban centres, where aerated water is consumed in some quantity, the yield may not be large. But its experience will serve as a guide to other provinces specially Bombay.

A cess at the rate of half an anna per maund is levied on sugar-cane consumed in factories in the U.P. and Bihar since 1938-39. The proceeds of this cess are estimated at Rs. 40 lakhs in the U.P. and Rs. 12 lakhs in Bihar during 1939-40. The revenue so realised is earmarked for the development of sugarcane growing in the respective provinces. Although this does not augment the general resources of the provinces, it releases the general tax payer from the liability of spending on the above object. Thus it increases the spending power of the provinces.

CHAPTER VI

PROVINCIAL DEBT

Provincial Debt before 1921

Before 1919 the Provinces were not allowed to borrow on their own account. Theoretically the Government of India was a unitary state. In practice the Provinces were made responsible for the administration of certain departments. The Government of India was reluctant to grant them the freedom of borrowing because of its responsibility to Parliament and the Secretary of State. The Provinces were allowed to draw from the Provincial Loan Account started in 1888 to enable them to finance expenditure by local bodies and for agricultural loan operations. As a result an anomalous situation arose under which the local bodies who derived their authority from the Provincial Governments could go to the market but not the parent bodies.

The situation was untenable in the light of the reforms of 1919. As a corollary the Provinces were empowered to finance their own loan transactions from the open market. The Government of India declared itself willing to accommodate the Provinces to facilitate the work of the newly created diarchical governments. But there were two limitations. The loans could be used to meet capital expenditure on the construction of works of a material character and lasting public utility. The Provinces were required to obtain the previous sanction of the Governor-General before approaching the open market to avoid unhealthy competition.

As a part of the final arrangements the pre-reform irrigation outlay incurred by the Central Government was transferred to the Provinces and made irredeemable, the rate of interest being 3·52 per cent. The balance of the Provincial Loan Account was also transferred to the Provinces and was to be liquidated in 12 years or earlier. Some of the Provinces could repay this debt from the accummulated balances.

Provincial Debt, 1921–1936

The following table will show the growth of provincial debt during the period 1921 to 1936 :

Province	On 1st April 1921 Due to the C. Govt.	Open Market	Total	On 31st March 1936 Due to the C. Govt.	Open Market	Total	Increase in debt.
	(In crores of Rupees)						
Madras ..	9.85		9.85	16.03		16.03	6.18
Bombay (Sind included)	12.12	9.38	21.50	72.89	.08	72.97	51.47
Bengal ..	1.18		1.18	8.40		8.40	7.22
U.P. ..	15.16		15.16	29.77	2.60	32.37	17.21
Punjab ..	21.85		21.85	31.82	4.09	35.91	14.06
Bihar & Orissa ..	6.85		6.68	7.38		7.38	.07
C.P. ..	4.64		4.64	7.95		7.95	3.31
Assam ..				1.88		1.88	1.88
Total ..	71.48	9.38	80.86	179.52	6.77	182.89	102.03

It can be said that there was a phenomenal growth of Provincial debt during this period. The debt rose by Rs. 102 crores or 125%. The provincial capital outlay came to about Rs. 7 crores per annum. The total funded debt of the Government of India rose from Rs. 566 crores to Rs. 779 crores, exclusive of the advances to the Provinces ; in other words, the Central debt rose by Rs. 213 crores or 40 per cent. The annual capital outlay of the Central Government came to about Rs. 14 crores.

The main cause of such a large capital expenditure by the Provinces was that many productive schemes of irrigation works such as the Lloyd Barrage in Sind, Sutlej Valley in the Punjab, Sarda Canal in the U.P. and Cauvery-Mettur in Madras matured for construction and were completed during the period. The Bombay Development Schemes were also completed during the period but now these have been de-

clared to be unproductive. In some cases like Bengal, C.P. and Assam the debt was incurred to finance recurring deficits.

The loan requirements of the Provinces were uneven. Fifty per cent. of the new debt was incurred by Bombay[1] alone while the requirements of Bihar and Orissa, the Central Provinces and Assam were insignificant. The Provinces preferred to borrow from the Central Government rather than in the open market. It seems that the Provinces did not have the same credit as the Centre and had to offer more attractive terms. The provincial debt charges amounted to Rs. 779 lakhs in 1936-37 as compared with Rs. 317 lakhs in 1921-22 showing an increase of Rs. 462 lakhs.

Provincial Debt under the New Constitution

Under the new constitution this situation called for a change. Any interference in provincial affairs was inconsistent with the conception of autonomy. Under Section 163 of the Government of India Act, the Provinces are free to borrow in the money market. In the case of those Provinces, which are indebted to the Centre the previous consent of the Government of India is necessary which it has been laid down will not ordinarily be withheld. The Provinces have now to make arrangements for their short term requirements and manage their unfunded debt.

Debt Settlement under the Niemeyer Award

Sir Otto Niemeyer recommended a scheme of decentralisation of balances which were of an intrinsically local nature or definitely associated with provincial functions. In the pre-autonomy days the Government of India acted as bankers to the Provincial Governments which function is now discharged by the Reserve Bank of India. In that capacity various deposits, interest carrying provident fund deposits, and interest free balances of the local governments and local bodies were lying with the Central Government. It has now been provi-

[1] Sind was then part of the Bombay Presidency.

ded that all receipts and liabilities on the above account should be assumed by the Provincial Governments from 1st April 1937. At this time the assets were equal to the liability. But instead of transferring the assets, it was decided to utilise the balances towards the repayment of the debt due by the Provinces to the Government of India as on 31-3-1936. In the case of Bengal, Bihar, Assam, N.W.F.P. and Orissa the balance of the debt outstanding after such repayment was to be cancelled as a part of the scheme of financial aid to them. The debt owed by Madras, Bombay, the Punjab and the U.P. was consolidated. The balance of the debt of the C.P. was reduced by Rs. 2 crores which represented the deficit of the Montford period, and the rest has been consolidated. The Barrage debt of Sind will be consolidated in 1942, and the rest has already been consolidated. The rate of interest was to the nearest quarter per cent. and the debt is repayable in the form of semi-annual equated payments of principal and interest spread over 45 years. The Provincial Governments have got a right to redeem 50 per cent. of the outstanding debt when the Government of India discharges the 1947-50 3½% loan. The rest can be repaid when the 1960-70 4% loan is discharged.

This arrangement has resulted in financial advantages to the Provinces. Before this the Government of India was the custodian of all cash balances—Central and Provincial, loan or revenue, large or small, fixed or current, whether available for a short term or a long period. In managing these balances and making advances the Government of India acted like a private banker. Its terms were also those of a private banker. No interest was allowed on small or current balances ; low interest was allowed on short term balances ; a moderate rate on long term deposits, a high rate on overdrafts and no accommodation was granted when inconvenient to the Government of India. The balance on 31-3-1936 was Rs. 11·45 crores. Even the Simon Commission objected to the practice

of the Government of India making "undue profits out of the balances for the benefit of the Central Budget".[1]

Under the present arrangement each Provincial Government keeps a minimum balance with the Reserve Bank which in turn manages the day to day affairs. The Provinces have to make arrangements for their ways and means requirements, and they have been able to obtain treasury bills at competitive rates. The Reserve Bank of India has been making ways and means advances also. The arrangement has worked well so far and is conducive to the maximum of economy.[2]

In 1925 the Provincial Loan Fund was started to systematise the loan operations of the Provinces. It was hoped that the institution will grow by itself and attain a position similar to that of the Public Debt Commission in England. The Simon Commission recommended the creation of a Loan Council composed of the Finance Ministers to co-ordinate the raising of loans. But the Reserve Bank of India has been able to solve the difficulties. In the previous regime the Provincial Governments had to offer better terms for loans than the Central Government ; under the present regime the Provincial Governments have been able to obtain loans on the same terms as the Government of India.

Although the question is now closed, we may say that the position could have been improved in certain ways. The Government of India could have cancelled the debt of all the Provinces and allowed them to start on a clean slate as has been done in the case of certain Provinces. It may be mentioned here that at the time of the Canadian Confederation it was agreed in regard to the debt "that the Central Government should assume all the debts and liabilities of each province".[3] It has been repeatedly pointed out that it was un-

1 Indian Statutory Commission Report p. 266.
2 Madras Budget Speech, 1939.
3 Financial Arrangement between the Provinces and the Dominion by A. W. Boos, p. 9.

fair for the Provinces to be saddled with pre-reform irrigation debt. It was met out of the revenues of the Imperial Government to which the Provinces contributed.

Another fact of importance is the date of redemption. With easy money conditions, the Government of India is able to reduce its interest charges. But the Provinces have been bound to a higher rate of interest for a long time. Had the Government of India seen its way to reduce the rate it would have been a great relief to the Provinces who are in need of funds.

The following table will show the comparative debt position on 1-4-1937 and the estimated debt at the end of the year 1939-40 :

Province	Debt due to the Central Govt.	Unfunded debt	Loans raised in the open market	Total	Debt due to the Central Govt.	Unfunded debt	Loans raised in the open market	Total
				(In crores of Rupees)				
Madras...	7.57	3.48	..	11.05	7.38	4.16	4.63	16.17
Bombay .	18.40	3.27	—	21.67	17.90	3.67	—	21.57
Bengal ...	—	3.97	--	3.97	—	4.62	1.00a	5.62
U. P. ...	25.77	3.01	4.62	33.40	24.97	3.48	6.6a	35.07
Punjab ...	26.99	2.39	4.07	33.45	26.00	2.95	6.66	25.61
Bihar ...	--	1.54	—	1.54	...	1.71	—	1.71
C. P. ...	3.30	1.50	.	4.80	3.00	1.68	1.20	5.88
Assam ...	—	.88	—	.88	—	1.01	.50a	1.51
N.W.F.P.	--	.15	--	.15	—	.18	.60	.78
Sind ...	29.27	.52	--	29.79	28.88	.56	—	29.53
Orissa ...	—	.25	—	.25	—	.34	—	.34
Total ...	111.3	20.96	8.69	140.95	108.13	24.48	21.21	153.82

The figures will show that there has been an increase in the debt of all Provinces except Bombay and Sind. The

a Includes loans still to be raised during 1939-40 as follows: Bengal Rs. 100 lakhs, U.P. Rs. 200 lakhs, Assam Rs. 50 lakhs. In view of the war conditions these loans may not be raised.

debt due to the Central Government is being reduced but there has been a steady increase in unfunded debt as was prophesied by Sir Otto Niemeyer. A major portion of the unfunded debt consists of contributions by the employees to the state provident fund. At present the receipts are larger than the disbursements. This sum is utilised by the Governments for its capital expenditure and ways and means finance. It may be pointed out that some of the Provincial Governments are issuing treasury bills, but these are discharged before the end of the year, and there is no floating debt to be carried over. The loans raised or to be raised during 1939-40 are meant for productive public works, except in the case of Bengal, Assam and the C.P.

CAPITAL OUTLAY

(a) Irrigation

We now propose to review the nature of the provincial assets productive as well as unproductive against the provincial debts. Irrigation is the largest commercial undertaking in charge of the Provinces and occupies a position in provincial finance identical to that of the railways in the Centre. During the year 1936-37, 3.2 crores of acres of land were irrigated out of 24 crores of area shown in British India, or 13.4 per cent., and the value of the crops raised in irrigated land was estimated at Rs. 114 crores.

The following table will show the financial position of irrigation works of all the Provinces during the year 1937-38.

	Crores of Rupees.
Total outlay on construction	144
Less financed from famine insurance grants or ordinary revenue	13
Borrowed funds	131
Gross Receipts	12·7
Working expenses	4·4
Interest charges	5·8
Net surplus after meeting interest charges	2·5

The yield on the capital came to about 6.33 per cent. After meeting the interest charges of Rs. 5.8 crores at 4.43 per cent. the net contribution to the Provincial Governments came to Rs. 2.5 crores or 1.9 per cent. on the capital invested. It may be pointed out that the irrigation works are classified into (1) productive and (2) unproductive. Productive works are those which are expected to yield on the expiry of ten years of their completion a direct return on capital invested at such a rate of interest as is fixed by the respective governments. The other works are classified as unproductive. The financial position of irrigation works as shown above is inclusive of both these classes. As against this, the working of the railways stands in good contrast. During the same period, the railways earned 4.24 per cent. on capital, and contributed only Rs. 2.75 crores to the general revenues of the Central Government.

The importance of irrigation in provincial finance varies. The Provinces of the Punjab, U.P. and Madras stand in one category. The Punjab is the land of rivers, and the wealth and prosperity of the province is dependent upon the harnessing of the water. It has some of the biggest canal projects with the largest capital outlay, 90 per cent. of which is productive. During the year 1937-38, irrigation contributed Rs. 4.73 crores or about 40 per cent. of the Punjab revenues against the total tax revenue of Rs. 5.41 crores. Madras and U.P. also receive a fair amount of contribution to provincial revenues from this source.

Bombay and the C.P. are in an unhappy plight. These provinces are liable to famines. Because of the absence of perennial rivers, it has not been possible to have large productive works in these provinces. Most of their irrigation works are protective. They have to subsidise the works to the extent of Rs. 22 lakhs per annum. Sind has a large outlay on the Sukkur barrage, but it has not begun to pay its way. The future of the province depends upon the successful working of this scheme. It has already created two problems

(1) the repayment of debt to the Central Government, and (2) the question of the settlement of water rates, which has threatened more than one ministerial crisis.

During the period, 1921-1936, many irrigation schemes were undertaken. Whereas the capital expenditure on Irrigation up to 1921 was Rs. 70 crores, during this period a further outlay of Rs. 76 crores was made. The important projects have already been mentioned before. Since 1937, the Haveli project in the Punjab has been under construction and is likely to be finished by 1939-40 with a capital cost of Rs. 3.5 crores. Madras is extending the Cauvery-Mettur Project and the U.P. is extending the Sarda Canal. The loan programme has therefore been limited in recent years.

In the U.P. irrigation from state tube-wells is rapidly developing. The Government is still exploring the possibilities, and during 1939-40 a sum of more than a crore will be invested on the same.

The Government of Bombay appointed an Irrigation Inquiry Committee presided over by Sir M. Visvesaraya. It has recommended that the Government should spend about Rs. 75 lakhs on protective works during the next five years, against Rs. 100 lakhs during the last ten years.

(b) Hydro-Electric Schemes

Electricity generated by water power is cheaper than that generated by the alternative method of production. Thanks to the enterprise of the Tatas, hydro-electricity is produced in the Western Ghats. The Governments of Madras, the Punjab, and the N.W.F.P. are exploiting their own resources. In the U.P. it is treated as a part of the irrigation system. By the end of 1939-40 the Government of the Punjab will have invested Rs. 8.1 crores on the Uhl Valley Project, that of Madras Rs. 5.44 crores on the Pykara Scheme, and that of the N.W.F.P. Rs. 72 lakhs on the Malakand Scheme. Although these works have been started only recently, they pay their way including interest charges, and are likely to be more productive in due

course. As a state enterprise, they will rank next in importance to the railways and irrigation works. The above mentioned governments are expanding the supply system and the capital expenditure to be incurred during 1938-40 is estimated at Rs. 175 lakhs for Madras, Rs. 84 lakhs for the Punjab and Rs. 29 lakhs for the N.W.F.P. The following table will show the working of the Hydro-Electric schemes during 1939-40.

Province	Gross Receipts	Working Expenses	Interest	Net Receipt
		(In lakhs of rupees)		
Madras	53	22	23	8
Punjab	50	35	28	—13
N.W.F.P.	4·6	2·4	—	2·2

(c) Bombay Development Scheme

This scheme received much public attention during the last decade. The project estimate of the Back Bay Reclamation Scheme originally sanctioned in 1922 was for Rs. 702 lakhs; but the scheme was subsequently modified in 1932 with a revised estimate of Rs. 723 lakhs on the basis of the decision of the Legislative Council during the 1927 Budget Session to reclaim and develop block nos. 1, 2 and 7 and to reclaim without development block 8 and abandon block nos. 3, 4, 5 and 6. The total net expenditure (exclusive of interest) till March 1938 was Rs. 617 lakhs, leaving a balance of Rs. 103 lakhs for the completion of the scheme.

The Development Department was abolished in March 1930 and charges pertaining to the schemes of the Department, excepting only those pertaining to the reclamation scheme have been transferred to the revenue heads (as distinguished from the capital head) with effect from 1930-31. The total gross expenditure (inclusive of interest met from revenue) on the Industrial Housing scheme was Rs. 416 lakhs, and that on the other schemes Rs. 305 lakhs till the end of 1938. The gross cost of all the schemes comes to Rs. 18.25 crores, out of which Rs. 6 crores has been met from the ordinary revenue by way of interest, while about Rs. 290 lakhs has been received from

the sale of lands, leaving a balance of Rs. 935 lakhs which has been met from borrowed funds.

About the working of the schemes in addition to the receipts mentioned above, the Government hope to realise about Rs. 2 crores from the sale of lands on the reclamation. The Government has still to incur more capital expenditure on the reclamation scheme as mentioned before, though there is already an estimated capital loss of Rs. 3 crores on this scheme, exclusive of the interest so far paid from revenue. The Industrial Housing and other schemes are earning Rs. 7 lakhs against an expenditure of Rs. 4 lakhs. The interest charges on the net capital outlay at the rate of 4.5 per cent. will come to Rs. 42 lakhs against a net income of Rs. 3 lakhs.

From this analysis, one will easily agree with the Finance Minister, who said while introducing the Budget of 1927-28 that "the provincial revenues of Bombay have been mortgaged for a period of 60 years for the sum of 20 lakhs a year (which has grown to 40 lakhs by now)". It is this department according to His Excellency the Governor of Bombay which was responsible for a series of deficits during the Montford period.[1] The strain on the financial resources of the Province on this account is very heavy and retards its progress.

(d) Civil Works

Capital expenditure on Civil Works includes that on buildings and other assets of non-revenue yielding character. A large expenditure has been incurred in this way on buildings intended for Commissioners and District Officers, the Police, Jails and Convict settlements, Legislative Councils etc. The total expenditure of all the provinces on this head by the end of 1937-38 comes to about Rs. 13 crores, the share of Bombay and the U.P. being nearly Rs. 4 crores each. The receipts on account of rents of building on the contrary did not exceed Rs. 32 lakhs during 1937-38. The burden to the provincial

[1] Address before the Associated Chamber of Commerce, Christmas 1929.

exchequer will be obvious. Objection to the expenditure from loans on police buildings in the U.P. was once raised by the Accountant General. In some provinces, it seems to be a matter of accepted financial policy to spend regularly on buildings for various departmental purposes from borrowed funds.

The following table gives the capital expenditure of the different provinces during 1937-40 in a classified form. The details of the expenditure have been already discussed.

Province	Irrigation	Hydro-Electric works	Civil works	Commutation[1] of Pensions	Deficit[2]	Total
			(In lakhs of Rupees)			
Madras	35	2,75	53	9	—	372
Bengal	—	—	—	—	87	87
U.P.	92	80	89	19	—	278
Punjab	3,75	84	26	12	—	4,97
C.P.	—	—	18	20	57	95
Assam	—	—	—	—	1,00	1,00
N.W.F.P.	—	45	—	—	—	45

Table XII in Appendix II will show the variation in the interest charges between 1936-37 and 1939-40. There has been a decrease in gross debt charges. The decrease would have been still more but for the fact that the provincial debt increased by Rs. 13 crores during the period. This decrease is the direct result of the cancellation and consolidation of the debt consequent upon the recommendations of Sir Otto Niemeyer.

By way of explanation it may be said that under the prevailing accounting procedure, the interest charges debitable to commercial departments are transferred and only the bal-

[1] In the first instance the commutation of pensions is financed from capital outside the revenue account. Thereafter it is written back to revenue account in 15 equated instalments.

[2] This represents deficit on revenue account met from loans. In case of the C.P. and Assam it is the cumulative deficit from 1936-37 to 1939-40 and for Bengal it is for 1939-40.

ance is shown as such. So long as the commercial departments are earning sufficient to pay their way, such a balance only is the burden on provincial revenues. In other cases proper adjustments are necessary.

Among the provinces, the case of Bengal, Bihar, Assam, N.W.F.P. and Orissa can be dismissed briefly. Their pre-autonomy debt to the Central Government is cancelled, and so the interest charges are insignificant. Nor have they any large loan programme so far.

In the second category we may examine the position of Madras, the U.P. and the Punjab. The gross interest charges range from 4 per cent. of the Provincial revenues in case of Madras and 12 per cent. for the Punjab. The following table will show more clearly the interest charges during 1939-40.

	Madras	U. P.	Punjab
	(in lakhs of Rs.)		
Net receipt from investments after meeting working expenses ..	149	163	474
Total interest charges on Provincial Debt	66	141	133
Net contribution to the Provincial revenues	83	22	341

Thus the commercial departments not only pay for their own way but make a net contribution to Provincial revenues.

The following table will stand in contrast to the former.

	Bombay	C. P.	Sind.
	(in lakhs of Rs.)		
Net receipts from investments ..	22	nil	69
Total interest charges	163	25	130
Net burden of interest	141	25	61

In Sind the Lloyd Barrage scheme is still taxing the people. The Government has to subsidise to the extent of 2 per cent. on capital at charge, the other 2.5 being earned by itself and absorbs 17 per cent. of the provincial revenues. It is expected that by 1942 it will begin paying its way. If it does not there is a gloomy future for the province.

The investment of the C.P. is mainly on protective canals which are unproductive. As such the interest charge is a burden on the provincial revenues and forms 5 per cent. of the same. But this serves as an insurance against famine. The deficit debt from 1921-1936 has been cancelled giving relief of Rs. 15 lakhs. Even then deficits have persisted and unless there is a change for the better, the interest and redemption charges on loans due to deficits will create problems difficult to solve.

Bombay stands by itself. The gross charges come to about 13 per cent. of the Provincial revenues. This is so in spite of the fact that Bombay has gained Rs. 14 lakhs by the consolidation of her debt as will be found in table I in Appendix II, and 22 lakhs by the conversion of the 6½ per cent. tax free Bombay Development Loan since 1936-37. After making adjustments on account of receipts from the Presidency Corporations for loans advanced to them, the net charges absorb Rs. 90 lakhs or 7½ per cent. of Provincial revenues.[1] Under Indian conditions with inelastic provincial resources such a burden is indeed heavy. These debt charges have drained the provincial resources and acted as a drag on its progress during the Montford period and continue to do so even now.

This brief review leads us to the conclusion that on the whole the position of the Provinces regarding their debt is very satisfactory. Besides in most cases the receipts from investments not only cover the interest charges but also leave a surplus for the general revenues of the provinces. This should serve as a justification for a forward loan policy recommended by us hereafter.

Prospective Capital Works

Except the Punjab, no other provincial government has any big scheme of capital works under consideration. After the completion of the Haveli project by the end of 1939, the

[1] Budget Speech, 1938-39.

Government contemplates to launch the scheme of the Bhakra dam while the Thal project is still under investigation. The Bhakra dam will provide irrigation for areas where no irrigation exists at present, and where the lack has been strikingly brought home during the last twelve months. The project was originally prepared in 1919 at an estimated cost of Rs. 14½ crores. In 1926 the estimates were revised at the then prevailing rates and put at Rs. 23 crores. In the final form as now contemplated the project is estimated to cost Rs. 12 crores. It is claimed by the Finance Minister that with the completion of Haveli, Thal and Bhakra schemes, it would be literally correct to say that every available source of water in the rivers of the Punjab would have been utilised and the Province would for the first time bear truly and fully the title of the land of five rivers.[1]

Review of Provincial Debt Position

By the end of 1939-40 the total provincial debt will amount to 150 crores of rupees, as against a total revenue of Rs. 90 crores a year. Compared with the public debts of other countries, this position is indeed satisfactory. The position is favourable even if we compare it with that of the Government of India whose debt amounts to Rs. 1200 crores with a revenue of about Rs. 115 crores a year including the net receipt from railways. The nature of Provincial Debt is mostly productive, the investment in irrigation schemes alone exceed Rs. 140 crores. The Government of India have more than Rs. 300 crores of unproductive debt and the interest charges to be met from general revenues comes to about Rs. 11 crores a year.

In view of this, it can be concluded that the Provinces can adopt a bolder policy of capital expenditure. We shall analyse the position of different provinces to make this suggestion more concrete.

The provinces of Bombay, Sind and the C.P. may be considered together. Bombay has a large unproductive debt the

[1] Budget Speech, 1939-40.

interest charges on which are fairly high as mentioned before. The Llyod Barrage debt of Sind has created problems which the financiers have not yet been able to solve. The C.P. has also large unproductive debt and recurring deficits. These provinces will therefore have to act with caution in launching schemes of capital expenditure.

The rest of the provinces are better situated. Madras, the U.P. and the Punjab have a large productive investment and the yield therefrom exceeds the payment. The debt of other provinces has been mostly cancelled, they can therefore embark upon schemes of capital expenditure with ease.

The scheme which will immediately strike one is that of rural development. It has been in the public eye and has justified its claim. The problem in India is of the poverty of the masses concentrated in rural areas and whatever enhances their economic and social welfare should have the first claim on the finances of the country.

When one reflects on the potentialities of raising loans by the Provinces for beneficial expenditure of a productive nature, one may heave a sigh of relief as against the oppression, which results from the difficulties of raising more revenue by taxation. With unlimited scope for more expenditure on schemes for the social and economic amelioration of the people, and with obvious limits to their capacity to raise more revenue by taxation, the Provinces will be fully justified in embarking upon productive schemes of capital expenditure financed from loans. Of course, the schemes will have to be well thought out, and wisely executed. If this is done, the direct and indirect advantages to the people concerned, and to the country in general will be sufficiently great to justify the policy. This will require a breadth of vision, a long range policy and a clear understanding of the requirements of each Province combined with the necessary financial acumen.

CHAPTER VII

FUTURE OUTLOOK

The Change in Policy

The foregoing review of the finances of the Provinces during the last three years leads us to two main conclusions: that the policy has been directed (1) towards the readjustment of the tax-structure so that the burden may fall on those most able to bear it; and (2) towards the expansion of social services, the main benefits of which will be enjoyed by the masses. In other words, the process may be described as one of gradual transference of purchasing power from the rich to the poor. This means that the Provinces under the new regime have definitely accepted the principle that the state must reduce economic inequalities by means of a more equitable system of taxation on the one hand, and more beneficial system of expenditure on the other. The duty of the state is no longer confined mainly to the work of security, but it also embraces the ambitious task of the social and economic amelioration of the people.

Change in the Tax-structure

The tax-structure has been changed partly by modifying or removing the rigours of the existing taxes, and partly by the imposition of new taxes. Substantial remissions have been granted under Land Revenue. The system has been overhauled in Bombay, and in other Provinces a revision is under consideration. The gradual extinction of Excise revenue has been planned in most provinces; a sum of Rs. 3 crores having been already given up under this item. The legislation for the relief of agricultural indebtedness has caused a heavy fall in the Stamp Revenue. Besides grazing fees have been abolished.

Whereas these steps are likely to remove at least partially the regressive character of the existing tax-structure, the situation has been further improved by the imposition of new taxes, which are so devised as to fall more on the rich than on the poor. For example, the taxation of agricultural in-

comes, of amusements, of sales of motor spirits and lubricants, motor cars, motor cycles, radio and wireless sets, of properties, of employments, of prize competitions will affect the poor, if at all, to a very little extent.

Expansion of Social Services

The effort to remove economic inequalities, is further in evidence in the form of schemes of expenditure on social services, which were hitherto neglected. The Rural Development scheme including the expanded activities of the Agricultural and Co-operative Departments which are in close touch with the rural population are sure to benefit the masses. The extension of primary education, the introduction of the system of subsidised medical facilities in rural areas, the construction of village water wells etc. will bring light and life to the rural folk. At the same time, the development of small scale and cottage industries will give employment to large masses of people, and increase their purchasing power. In brief, the aggregate effect of these schemes must be to raise the standard of life of the people.

Future of Provincial Finance

It must however be remembered that this is yet the beginning of state policy in the right direction. The tax-structure demands careful readjustment. The larger the proportion of public revenues contributed by indirect taxes on consumption, the greater is the likelihood of inequitable regression.[1] In modern schemes of taxation increasing reliance is placed on direct taxation with the result that indirect taxation has shown a tendency to fall in the background. The Indian tax system however shows a striking contrast to this.

Besides finding new sources to remove this anomaly, we have to remember that there is unlimited scope for greater expenditure by the state on various useful and productive activities. In the words of Sir Walter Layton, "In India it should

[1] Lord Stamp: Current Problems in Finance and Government. Ch. X.

be possible to stimulate production and increase the welfare of the people by public expenditure designed to give greater economic security, better physical well-being, and education. Taxation may be the only practical means of creating a better and more secure livelihood. It is both possible and desirable to improve the economic and social conditions of the Indian people by a substantial increase of expenditure on nation building services and to raise the revenues for the purpose."[1]

This problem of revitalising the life of the masses, and raising their standard of life, requires adequate powers for proper solution. Under the new Act the powers of the Provinces have increased, but as we have pointed out before they have been limited and circumscribed in many ways. Several important functions having vital bearing on the economic and social life of the people are beyond the control of the Provinces. And it is difficult for them to embark on comprehensive schemes of reform because of these and other limitations. We are here concerned mainly with the financial difficulty, and we shall consider in brief, some of the measures which may enable the Provinces to overcome the same.

Retrenchment

While planning schemes of more expenditure on desirable social services, it is also necessary to retrench existing expenditure on those items which for various reasons have been responsible for unduly heavy expenditure. We do not propose to go into details at this stage; these have been referred to in the appropriate place. But we may refer to one general item of retrenchment, which has presented difficulties to all provinces, namely, reduction in the salaries of state servants. This item absorbs more than one-third of the Provincial revenue,[2] and needs careful scrutiny.

[1] Indian Statutory Commission Report Vol. II p. 208.

[2]

Province	Total Provincial Expenditure	Salary charges (In Crs. of Rs.)	Percentage of Salary charges to total.
Bombay 1937-38	12.1	4.2	35
C. P. 1937-38	4.7	2.2	47
U. P. 1937-38	13.3	5.7	42

Since 1937 the question of salaries has become of great importance because of the financial situation in which the Provincial Governments find themselves. It was impossible with any sense of justice to maintain the existing scales of salary as they failed to satisfy the principle that the administration must be economical and must be within the means of the people.[1] Several Provincial Governments have appointed Committees to find a solution. The approach has been twofold: (1) to suggest lower scales of pay and (2) to suggest reorganisation of the administrative machinery, involving reduction in existing posts.[2] Though measures of this nature will help to some extent in releasing some resources for social expenditure, the problem will not be solved till the position of the Imperial Services which has been guaranteed under the Act and is under the control of the Secretary of State, is brought under that of the Provincial Governments under whom the members of these Services may be engaged.

Additional Taxation

In our review of existing and new sources of revenue we have seen that the scope for raising more revenue by the

[1] Sir William Beveridge, the late Director of the London School of Economics sums up his views about the present and the future of civil services by comparing them to a very famous order of St. Francis. "I will make one change only;" he proceeds, "I believe that the civil servant when he enters the service will in the future as now take upon himself the triple vow of poverty, anonymity and obedience.

"I would like to say about poverty, that I mean poverty, not destitution. There is technical distinction in the terms. I do not mean that the civil servants should not have enough to live on, but I do mean that he should not try to compete with the business world in profits and incomes. I think the civil servant will look upon his salary as maintenance adequate to the needs of himself and to bring up a family if he has one according to the highest standards of education in the country, and that it is not always the standard of the business world and profit making world."

[2] Cf. Sind Reorganisation Committee; the C.P. Economy Committee, the Thomas Committee in Bombay. A Committee has reported on the problem in the Punjab. In the U.P. a committee of the Legislature was appointed, but its report has not been published.

Provinces is very limited. The tax on Agricultural Income and the Sales tax have been tried in different Provinces, and have not proved adequate for meeting expanding needs. The scope of the Employment Tax has been limited by recent Parliamentary legislation. Among the other sources of revenue, which may be expected to bring relief to the Provinces, we may mention the Inheritance Tax. Under the Act, this tax will have to be levied by the Centre for the exclusive benefit of the Provinces. Apart from this constitutional question, we may consider its financial value.

Duties on inheritance or succession are levied in most of the countries of the world. They satisfy the modern requirement of a good tax *viz.* ability to pay. As a form of taxation which falls upon accumulated wealth they have found special favour with democratic thinkers and occupy an important place in the taxation system of the countries in which they are imposed. Taxation of inheritance has also a social significance, in as much as it is an instrument for removing the inequalities of modern economic life.

The question of the introduction of inheritance tax in India was first considered in 1859, and the practicability and desirability of such a tax have since been discussed on numerous occasions. The chief objections advanced so far, are that the habit of investment is in its infancy in this country and such a tax will discourage saving, and that the joint family system introduces complications which cannot be surmounted. The question of levying such a duty was considered in the old Bombay Legislative Council during the budget session of 1932 but was shelved on similar grounds. The Government of India recently appointed Sir Allan Lloyd of the Central Board of Revenue to study the feasibility of such a tax. The Provincial Governments were asked to give their opinion on the matter. The report and the replies have been treated as confidential and valuable information on the subject has thus been withheld from the public. But the information given

by Sir James Grigg that most of the Provinces either did not consider the matter or were opposed to it is really deplorable. The real reason seems to be the absence of sound public opinion on the question preventing any step being taken in the matter. It is necessary to take early steps for its imposition and make up for the deficiency of the past.

Relief from the Centre

The justification of relief from the Centre is that the welfare of the people is as much the concern of the Central Government as of the Provinces. Further, the Central Government must share the cost of Prohibition ; under other federal systems, this would have been a Central liability. Besides, they have unjustly retained the provincial share of Income Tax. The Central Government derive large revenues from import duties on petrol and motor cars, while the Provinces are made responsible to maintain the roads, which is a heavy charge on their meagre resources. In view of these claims of the Provinces on the Centre, and their pressing needs, the case for some relief from the Centre is both urgent and strong.

It would be useful in this connection to examine the position of Central finance. The following figures will give a comparative idea of the same.

(In Crores of Rupees)

	Revenue 1936-37 Accounts.	Revenue 1939-40 B.E.		Expenditure 1936-37 Accounts.	Expenditure 1939-40 B.E.
Tax Revenue ..	77	73.5	Defence ..	50.7	53.9
Railways (net) ..	—	2.2	Debt service ..	12.6	12.6
Defence ..	5.2	8.7	Civil Administration ..	11.3	11
Others ..	5.5	7.7	Aids to Provincial Governments ..	2.8	3.6
Total ..	87.7	92.1	Others ..	12.1	11
Deficit ..	1.8		Total ..	89.5	92.1

For the purpose of comparing the figures, we have to remember that during the interval Burma has been separated. We notice a reduction in tax revenue but not in expenditure. It has increased by Rs. 2·5 crores. This has been met from the increased taxes, chiefly Customs and Income Tax, subventions from the British Government for defence, and the extraordinary payment by Burma in liquidation of her debt.

It is essential for the Government of India to readjust its expenditure to enable it to discharge its obligation to the Provinces. The main items of expenditure are defence, debt service and civil administration. Debt is a contractual obligation difficult to reduce. What we have said about retrenchment in the budgets of the Provincial Governments is applicable *mutatis mutandis* to the Central Government also.

The largest item of expenditure is that on the defence services. It is well-known that compared with her requirements India has to spend large amounts on these services. It has now been acknowledged, though indirectly, that the Indian Defence Services are maintained on a scale not required for merely Indian defence. This is borne out by the recent arrangements by which large amounts of money are to be contributed by the British Government for modernising the Indian Army, which is often required to serve in areas which have no connection with the defence of India.

Another way by which, the Centre can improve its own finances and thus help the Provinces is to reorganise Railway finance thoroughly. We do not propose to go into the details of Railway finance, but it is well-known that the budget of the Central Government is dependent on the contribution from the Railways. Unless Railways are able to do better, the present state of affairs will continue, and the day when even the share of Income Tax due to the Provinces can be released will be far off.

We have seen that there are difficulties in the way of retrenchment, that the scope for additional taxation is limited

and that the possibilities of the Centre releasing more sources of revenue for the Provinces are not great. Though we would emphasise the need for exploring all these avenues of bringing about improved financial conditions for the Provinces, we would also suggest that the need for more expenditure in certain directions is so urgent that the Provinces will be fully justified in resorting to loans. We have already explained the circumstances under which such loans may be raised, and we hope that those in charge of Provincial affairs will not hesitate to embark on a loan policy, if they have schemes of expenditure of a productive nature.

Apart from political controversies, the success of the new constitution in the Provinces will greatly depend on Finance. The foregoing pages have shown the extent to which the forward policy of the popular ministers must depend on Finance. If the necessary foresight to bring about a state of affairs in which this demand for more finance by the Provinces is not met in time, we shall have one more cause of unrest in the country. Democratic institutions increase the appetite for state expenditure, and if this cannot be satisfied, there is bound to be dissatisfaction among the people. Let us hope that the realities of Provincial Finance as analysed in this book will bring home to those concerned the urgent need for bringing about that balance in our financial system, which will enable us to march surely but steadily towards our economic goal.

APPENDIX I

SALES TAX

Introduction

Since the Great War a tax known as the sales tax has been introduced in the tax systems of many countries under different political, economic and social conditions and has assumed a position of great importance in public finance. This is a new experiment in taxation and it is perhaps too early to pronounce a judgment on it. In view of its popularity with Finance Ministers, and in view of the fact that it is being introduced in some of the Provinces, we have thought it proper to assemble the available data on the subject and analyse the same so that the experience of other countries may be useful to us in this country.

Nature of Sales Tax

The Sales Tax is a levy imposed upon commodities or services. As such, like customs and excise duties, it is classed as an indirect tax; but, unlike customs duties, it is confined to internal transactions in commodities, while customs duties are levied on goods crossing national boundaries at the time of importation or exportation. Excise is a tax on commodities of local manufacture, either at some centres of production, or before sale to home consumers; and the duty is to be paid by the manufacturer or producer, on the issue of the excisable article from the place of manufacture or production. Sales Tax can be imposed at any of the stages from production to consumption, *i.e.*, on the producers, wholesalers and/or retailers. The seller is liable to pay the tax in arrears, that is, some time after the transaction is made.

Different Types of Sales Tax

The categories of the Sales Tax are numerous. The tax when imposed on retailers only is called retail sales tax. When it is applicable to sales by producers, wholesalers and retailers, it is known as general sales or turnover tax. Besides, there is

the selective sales tax or a tax on selected commodities only. In this case specially, it resembles excise. Although the tax is generally on sales of commodities, it sometimes affects the sale of professional or other services, of real property and other intangible property, such as the receipts of interest, dividends, rental payments, wages and salaries as in some States of the U.S.A. In such cases the tax is known as gross receipts tax, and it includes within its scope all receipts, whether by sale or otherwise. From this it would be obvious that the base of the tax can be as broad as the legislature desires, subject to constitutional limitations, if any.

Popularity of the Sales Tax

The Sales Tax is known to have been levied in ancient times as well as in the Middle Ages. But we shall confine ourselves to recent experience. It has been levied mainly as a result of the financial stringency created by the World War. Though introduced in Germany in 1916, it took a permanent form in 1918. France, Italy, and Czecho-Slovakia adopted it in 1919. Russia, and Belgium in 1921, and a few other European countries followed suit. In the U.S.A., the tax developed during 1929-33 owing to financial embarrassment caused by the depression. It found its way to Canada in 1920, Australia in 1930, and New Zealand in 1933. In America, it is a source of State taxation. In other countries, it is a national tax subject to a nominal share for local or State Governments. By the end of 1937, it was levied in 29 States of the U.S.A., three Dominions of the British Commonwealth, 12 countries of Europe, and six Republics of South America. Although it has found its way to the States of the U.S.A., the Federal Government has refused to adopt it, in spite of repeated attempts, during the years 1921-22 and 1932-33. In the United Kingdom, the tax came under the scrutiny of the Colwyn Committee on National Debt and Taxation. The tax was rejected as it failed to meet the modern requirements of a good tax, *viz.*, ability to pay. In the Committee's view,

Income-tax which can be graduated, is a far superior form of tax. Besides, it is felt that in Great Britain the tax payer is willing to bear a larger burden of direct taxes.

Base of the Sales Tax

The next step will be to consider the base of the tax. In Germany, it is a general sales tax on total turnover at every stage and includes sales of services. In Belgium, it is a general sales tax, but retail sales are excluded. As such, it is known as wholesalers' and manufacturers' sales tax. It affects all the transactions consummated in the country including the imports. In addition, there are special rates for specified articles. In Canada, the tax is levied on the sales of wholesalers, producers, manufacturers and importers, as in Belgium. In France, it is a general tax with specified rates for special industries, and higher rates for luxury articles. Imports are also taxed at the same rate; but in cases where the vendor has no place of business in France, the rates are doubled. In six of the States of the U.S.A., there is the gross receipts tax with variations from State to State. In addition to the receipts on account of the sales of commodities and services, receipts from rent, interest, etc., are also included for purposes of taxation. In three States, there is a general or turnover tax ; in eighteen others there is a tax on retail sales only. In Washington, there is a tax on specified enterprises, while Delaware has a flat licence tax. Two conclusions emerge from this analysis. On the one hand, the base and the scheme of the tax vary from place to place, while on the other, the general or turnover tax at all the stages from production to consumption is very uncommon.

Exemptions

Exemptions from the Sales Tax can be classified as follows :—

(1) Exemptions to small vendors by prescribing a minimum for total sales below which such sales shall be

free of tax, or a minimum for individual sales below which sales shall be free of tax.

(2) Exemptions in respect of certain commodities in case of retail or turnover tax.

(3) Other exemptions.

The first is administratively difficult, though otherwise simple, and may affect productivity. Under this system, individual sales below a particular unit of business houses, and stores having gross sales below a prescribed limit are exempted. But the disadvantage is that the tax can be easily evaded by splitting up the transaction. The non-taxable limit has been prescribed in only four States of the U.S.A., and varies from $ 600 in Michigan to $15,000 in New York.

Sales Tax on commodities which are exported places the producing country at a disadvantage as compared with countries not having such a tax. Therefore, all the countries have made provisions to exempt such commodities. The constitution of the U.S.A. forbids the States from levying a tax on commodities which enter inter-state commerce. The other commodities exempted are prime necessities, such as cereals, meat, milk, bread, sugar, etc.[1] In some cases agricultural products and other natural products are also exempted.

The third type of exemption includes State securities, receipts of non-profit organisations and public service corporations, receipts otherwise taxed, and sales by and to the States. Where the services are taxed, the services of the professional men such as lawyers, doctors, etc., may be exempted, as in France, where agriculturists are also exempted.

Rate of the Tax

As regards the rate to be charged, the principle generally adopted is that, where the base is broader, the rates are lower because of pyramiding effects. In such cases, as the tax is to

[1] Though Bastable would say that the exemption of necessaries from taxation must be contingent on the possibility of obtaining adequate revenues. Public Finance, p. 513.

be paid at every stage, the tax element in the price of the commodities is also included for the purpose of taxing at the subsequent transaction. The effects become cumulative, and the tax element in the price progressively increases. With a view to mitigate this regressiveness, the minimum rate that has been found in such cases is 1/25 of 1 per cent. Otherwise, the rate varies from 1 per cent. to 5 per cent. Luxury goods are taxed at special rates in some countries. The rate on such goods rises upto 16 per cent. in France and 25 per cent. in Hungary. The yield depends a great deal upon the base, the rate and the administrative machinery.

Administrative Requirements

The administration has great responsibility in making the tax productive by preventing evasion.[1] The first thing necessary is to ascertain the number of probable tax-payers, and for this the tax-payers may be required to take a licence for the business or to get themselves registered with the authorities. Half the number of the States levying the Sales Tax in the U.S.A., require the sellers to take out licences. In others, regular enumeration is made. After recording the probable tax-payers, the frequency of the returns of their business to be submitted and the method of payment should be prescribed. The returns may have to be submitted monthly or yearly. The taxes are to be paid with the returns, and the final adjustments are made thereafter. Once the returns are issued, the next stage is their verification. For this a large field force is required to carry out inquiries. The tax is not so difficult to collect, or easy to evade as is sometimes imagined, owing to the keeping of books of accounts even by small traders and where books are not kept, an estimated tax may be levied, as in France, which has been quite workable. The collection of the tax does not involve the same intricacies of accounting as

[1] "The State has to postulate that there will be considerable number of people ready to take advantage of any laxity or loophole" Lord Stamp, Principles of Taxation, p. 114.

in the case of Income tax. The frequent examinations of sales, ledgers, registers, and other sources of information tend to curtail evasion very considerably. The collection charges vary from 1 to 4 per cent. of the total yield, and, as such, the Sales Tax is capable of bringing more revenue than does the Income tax.

Administrative success depends on the text of the legislation. All the terms such as the sales tax, retailers, etc., should be clearly and distinctly defined. In matters of taxation of commodities, the administration will be easier if the rates are lower and the exemptions few. It is because of this that manufacturers' and wholesalers' tax confined to selected commodities has proved equally productive. Such a tax is to be found in Belgium, and the payment is by affixing stamps on individual transactions.

In matters of retail tax, one difficulty is to differentiate sale for consumption from resale. This can be avoided by issuing certificates. The administrative authority in some of the States have ruled that resale certificates signed by the purchaser, in which he states that he is buying the article for resale and not for use is to be taken as conclusive, and the vendor is not liable for the tax. As a corollary the purchaser is subsequently taxable, unless he in turn can produce a resale certificate.

Selective Sales Taxation

The commodities so far selected in America include cigarettes, alcoholic beverages, matches, playing cards, automobiles, electrical energy, gasoline and tobacco. The test hitherto employed is one of adequacy. It would be useful to consider the guiding principles in selection of commodities for taxation.

Firstly, the commodity should have low elasticity of demand. If the commodity has great elasticity of demand the demand will fall due to rise in prices as a result of taxation. If the same commodity is subject to increasing returns, the contraction of demand will throw a proportionately greater burden on the consumers.

Secondly, the commodity taxed should have low elasticity of substitution or in other words should not be capable of being easily replaced. Further, the observation of Bastable with reference to the taxation of luxuries can be extended to the taxation of any other commodity. To prevent the replacement of the taxed article, all available substitutes will have to be taxed, otherwise they will be consumed instead of the taxed article.[1]

In view of these considerations, it is better that the tax rates should be as low as possible. From this it follows that apart from administrative convenience it is better to collect the desired revenues by taxing many commodities lightly rather than a few heavily.

In those countries in which only a few commodities are available for taxation it is better to tax those whose total sales are the greatest. In other words, the commodities selected should have a large proportion of individual budgets devoted to it and should be such that they enjoy a wide market[2].

Incidence of the Sales Tax

It is essential to find out by whom the tax is finally paid in order to determine its comparative fiscal and social effects. The usual way to determine the incidence of taxes is to classify them into direct and indirect. One may also turn to Edgeworth's distinction between taxes on margins and taxes on surplus. When the tax liability is proportional to property or services exchanged the vendor can immediately shift the tax in part because it affects his margin of profit. On the other hand if the tax is laid upon net profits income or other surpluses the tax payer generally cannot shift the burden because the tax by definition does not enter and become a part of his cost.[3] There is no doubt regarding the place of sales

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1 Op. Cit. p. 540.

2 Cf. F. W. Joseph : Excess burden of Indirect Taxation. Review of Economic Studies, June 1939.

3 F. Y. Edgeworth : The Pure Theory of Taxation. Economic Journal, Vol. VII, pp. 46 ff.

taxes in this classification. They are pre-eminently taxes on margins and as such the vendors will pass them on to the consumers.

Secondly, sales taxes being taxes on commodities should not fall on the producers. If they do they will harm producers as it is independent of income as will be obvious from the following illustration :

Burden of a 1 per cent. sales tax.

	Retail grocer Rs.	Wholesale grocer Rs.
Gross sales ..	100,000	100,000
Net profits .	3,000	1,000
Tax at 1 per cent .	1,000	1,000
Profits after tax paid	2,000	Nil
Percentage of tax on profits	50%	100%

Bastable had recognised this fact long ago and had observed that none of the burden remains on the producers who pay the tax immediately and the consumers have no way of passing it on to another set of persons.[1]

As a general proposition it can be said that complete shifting of taxes to consumers by producers depend on the perfect mobility of labour and capital. It depends upon whether the production is subject to increasing, constant or decreasing returns; whether the demand for the goods is elastic.

In spite of the desirability of complete shifting it may be pointed out that this is not possible. In this case we may refer to some investigations recently carried out in America. After a decade of experimentation with general sales taxation on an extensive scale, the shifting is found inequitable and irregular as will be seen from the following table :[2]

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[1] Op. Cit. p. 548.
[2] A. G. Buehler : General Sales Taxation, p. 204.

Article	Taxable stages	Percentage addition to retail price at 1 per cent. tax.
Sugar	4	3.44
Bread	3	2
Beef	3	2.25
Pork	3	1.87
Suit of men's clothing	7	2.34
Pair of men's shoes	6	3.30
Cord tyre	11	3.30
Tafetta silk	4	2

It can be concluded that the commodities do not pass through the same number of taxable transactions nor is the incidence proportional to the number of taxable transactions. Thus the incidence of general sales taxation is very unequal.

A study of the "Federal Commodity and Services Taxes expressed as the percentage of the Retail Prices" was made by the 20th Century Fund in connection with their survey of taxation in the U.S.A. Although the retail Sales Tax was excluded, the conclusions are useful for our study.

When a tax is shifted to the consumer, the final retail price is composed of two parts, the commodity element and the tax element. The percentage relation between the first and the second is the measure of the burden of the tax on the consumer. The following table will show the results of the inquiry :—

Commodity	Tax rate per-cent.	Tax base	Tax as percentage of retail price including tax	Tax as percentage of retail price excluding tax
Toilet preparations	10	Sale price by producer	7	7.5
Automobile tyres...	2¼	Pound	2.5—4.3	2.6—4.5
Radios	5	Sale price by producer	2.5	2.6
Electrical energy...	3	Do	3	3
Gasoline	1c	Gallon	5.3	5.6
Matches	2c	1,000 matches.	26	35
Telephone messages.	10c 20c	Charge to consumer on each message	9—16.7	10—20
Cigarettes	3	1,000 cigarettes	48	92.3

The following conclusions are obvious from the above table. First, where percentage tax is levied, it is not possible to shift the whole of the tax to the retailers. It is interesting to note that a small flat tax in fact becomes a very heavy percentage tax as in the case of matches.

It is obvious that the factors coming in the way of complete shifting are competition and the possibility of substitution, the nature of demand for commodities, and the general trade conditions. In times of depression, when the general price level is falling, it is not possible to shift the tax at all. Conversely, in time of rising prices, the tax can be shifted without the consumer feeling it.

Regarding the effect of the changes in demand, if the demand is elastic, the rise in price may contract demand, and as such, shifting is not possible. In case of inelastic demand, as in the case of necessities of life, it is possible to shift the tax, but it is not advisable to tax these commodities. This is the reason why, in selecting a commodity for taxation, it is advisable to select a semi or conventional luxury to make it productive. In the case of articles of production subject to increasing cost, it is possible to shift the tax, but not in the opposite case.

It may be pointed out that the sellers will always try to shift the tax in full. In the U.S.A. the trade associations and stores have insisted on mandatory provisions for shifting. Two methods have been adopted for this. The first is the bracket system under which the tax is separately added to the sales price. The second is the fractional cent device. The State sells coupons to the retailers. The retailers resell them to the consumers. The consumers are required to hand over the coupons of the value of the tax to the retailer at the time of purchase enabling the State to collect the tax in advance.

Adequacy of the Tax

We are now in a position to examine whether the Sales Tax satisfies the principles of taxation. First as to adequacy, it

may be pointed out that large sums have been contributed to the national fisc in some countries by the tax. But at the same time, it has been difficult to realise optimistic estimates. Some of the advocates of this tax in America held out estimates of six billion dollars against half a billion by others at the rate of 1 per cent. The actuals for the year 1935-36 were 392 million dollars contributing 5.9 per cent. of the total revenue for the State and local bodies, and 3.7 per cent. if the Federal revenue is included. This may serve as a warning regarding the probable yield of the tax and difficulties of estimating the same.

Innocuity of the Tax

Next, we may consider the effects of the tax on the com munity. One of the effects of the General Sales Tax is the influence it is supposed to exert towards integration of industries and changing the methods of business such as the substitution of brokers for wholesalers, and the extension of selling on consignments with a view to avoid taxable transactions. If a group of processes can be brought under one owner from the first stage of manufacture to the finished product, the commodity can escape several payments of the tax, which an article which passes through several independent processes will have to bear. This will put the single process and small manufacturers at a disadvantage as compared with larger manufacturers of finished products. This is the strongest argument propounded by the opponents of the tax in the U.S.A. and in Great Britain. This effect was prophesied in Germany at the time the Sales Tax was first introduced, and was put forth by the Federation of British Industries in England when it was under consideration there.

In Germany, the law of 1918 attempted to protect the small independent manufacturers against this tendency by providing that transfers from one branch of business to another should be taxed as if they occurred in another business. But the difficulty encountered was the determination of the number of

taxable transactions which was bound to be arbitrary and as such the provision was eliminated in 1919.

This problem is also found in the States of America specially with reference to mining and extracting industries. In the absence of classifying provisions, or authoritative ruling, the practice varies from State to State, and much depends upon the administrative machinery. The problem is very complex and can be clarified only by amending the law.

Further, if the tax is a general one, and is passed on to the consumer, as it is intended to be, it becomes cumulative in character or pyramided. In other words, the tax being levied at every stage, the price of the subsequent transaction is augmented. In case it is not shifted, it will be a tax on gross receipts of business, which, however, is no indication of its profitableness.

Administrative Convenience

The tax which each individual has to pay ought to be certain; it should not be complicated, and should be convenient. The Sales Tax is paid in small doses and so can be said to be convenient. But with numerous qualifications, exemptions, deductions, and rates, the system becomes complicated. If the Sales Tax is levied on the last transaction, the tax-payer can know the amount of tax paid but not otherwise. From this it will be seen that, on the whole, the Sales Tax fails to satisfy the principle of administrative convenience.

Ability to Pay

Like other commodity taxes, the Sales Tax is regressive in character. It does not take into account the way in which the income is earned, the way in which it is spent, and the number of dependents or savings from income. It is a tax on consumption or on expenditure, and, as such, discriminates to the disadvantage of the poorer classes, who spend a larger proportion of their income on necessities than the wealthier classes. There are luxury taxes in some countries, supplementary to the Sales Taxes, but it is a question whether they are suffi-

ciently heavy to counterbalance the effects of Sales Taxes on the poor classes.

Nature of Sales Tax

In order to consider the suitability of Sales Tax in India, we should bear in mind the structure of our taxation and the condition of the people. A large percentage of our total revenue is derived from indirect taxation. The principal sources of direct taxation in the country are Income tax and Land Revenue. Land Revenue does not conform to the chief canon of direct taxation—ability to pay. It is largely borne by the poor agriculturist. The tax system is thus regressive in character, and this is more true of the Provincial tax system taken by itself than of the Central, where the principle of progression in Income tax mitigates to some extent the otherwise heavy burden on the poorer classes. The Sales Tax is an indirect tax, likely to intensify the regressive nature of our present taxation system. From this general point of view the Sales Tax must be pronounced as unsuitable to Indian conditions.

Sales Tax—an Emergency measure

It is obvious that the Sales Tax has been introduced in other countries under emergency conditions. It is possible to assume that we in India are passing through emergency conditions sufficiently acute to justify the imposition of taxation on the sales of commodities—a system which is inequitable, tends to shift the burden to the consumer and is regressive in nature. The nation-building departments have been starved for many years. The Provinces responsible for these departments are faced with meagre resources to meet their increasing requirements. The policy of Prohibition will further reduce these resources in most of the Provinces. The possibilities of retrenchment have been explored, and though some avenues can still be tapped under more favourable circumstances, it is true to say that in some other cases, further retrenchment may be bad economy. If the aspirations of the

people for more expenditure on useful activities are to be satisfied, some bold step will have to be taken. Among the new sources of revenue open to the Provinces, there are few which can give large yields. The Sales Tax is perhaps the only important source which can bridge the widening gap in the Provincial Exchequer. It is in view of these peculiar circumstances alone, that for want of a better alternative, the Sales Tax may be accepted as a fresh source of revenue in the Provinces.

Constitutional Position

Having laid down the conditions under which the imposition of Sales Tax in India may be justified, we shall first consider the constitutional position regarding this tax, particularly with reference to the relations of the Central and Provincial Governments under the Government of India Act, 1935.

Under item 48 of the Provincial Legislative list, " Taxes on sales of goods " is a Provincial source of revenue. On the other hand, under item 45 of the Federal list, " Duties of excise of tobacco and other goods manufactured or produced in India except " is a Federal source of revenue.

The Government of the Céntral Provinces levied a tax at a rate of 5 per cent. on the retail sales of motor spirits and lubricants. The Government of India contested this as *ultra vires* the Provincial Legislature, and referred it to the Federal Court.

The claim of the Government of India was that any tax imposed on a sale of any goods (other than a turnover tax) is an invasion of item 45 referred to above. It was immaterial whether the commodity was subject or likely to be subject to any excise. Excise duty can be levied on goods manufactured or produced in India only, but if the imported commodities were singled out for taxation it would infringe the provisions of Section 297 (1) (B) of the Act regarding discrimination. In other words, the Government of India were

opposed to selected commodity taxation by a Province, irrespective of the stage of taxation, *i.e.*, production or manufacture, wholesale or retail. In their view the Provinces can levy only a turnover tax. The Federal Court rejected the claims of the Central Government. In view of the decision of the Federal Court, the position is that the Provincial Governments can levy turnover tax or commodity taxes at retail and wholesale stages. The Provincial Governments cannot levy commodity sales tax at the manufacturing stage. It is still a question whether turnover taxes can be levied at the manufacturing stage. Taxation on services and tangible property is definitely excluded from the sphere of the Provinces.

Sales taxes in different Provinces

Since the judgment of the Federal Court was delivered, the Provinces have levied different kinds of Sales Taxes. They have preferred to tax specified commodities. The only example of general sales tax so far levied is furnished by Madras. Among the commodities taxed, the motor spirit is taxed by all the provinces other than Bengal and Orissa. Motor lubricants is taxed in the C.P. and Assam ; electricity in Madras, Bombay, and Bengal ; tobacco in Madras, Bombay and C.P. Cloth in Bombay (now suspended) ; and certain articles of luxuries in Assam.

Possibilities under Indian conditions

We shall now examine the possibilities of the extension of sales tax in the economic, political and social background, the constitutional one having been already examined. We shall first take up the selective sales tax.

Selective Sales Tax : We have already laid down the guiding principles in such selection. We may further classify the commodities as follows and examine their possibilities.

1. Necessities of life.
2. Semi-necessities of life.
3. Luxuries.
4. Raw materials.

5. Articles of Export.

In a poor country like India articles of necessity should be exempted, lest it may be an unduly heavy burden on the masses of the people. The articles of export should also be exempted as it is not possible to pass on the tax to the foreign purchaser. It will have to be borne by the seller who is ultimately the poor agriculturist. Raw materials will also have to be exempted to prevent the pyramiding effects of the tax on the ultimate price. Thus we are left with only luxury and semi-luxury articles. Lord Stamp has observed that inherent difficulties are involved in the taxation of luxuries and these are almost insuperable.[1] But the continued collection of luxury taxes by a number of nations possibly indicates that they are not total failures. These articles are likely to be few in India. We may say that the following commodities may be considered :

1. Motor cars.
2. Tea.
3. Coffee.
4. Cinematograph films.
5. Pneumatic rubber tyres and tubes.
6. Cement.
7. Hosiery.
8. Toilet requisites and soap.
9. Clocks and watches.
10. Aerated waters.
11. Patent medicines.

Wholesalers' Sales Tax : If a tax is levied on wholesale transactions, it is possible that it will be monopolised by some distributing provinces and other big commercial centres. In such a case the interior may be starved of revenue in spite of the fact that they will have to bear the burden of the tax.

[1] Principles of Taxation, pp. 106-14.

Further, with a view to evade payment the place of sale may be changed from one province to another.

General Sales Tax or Turnover Tax: The disadvantages of this tax are that it encourages the integration of industries to the detriment of small producers and sellers. It is inequitable in nature because the commodities do not pass through the same number of transactions. Thus the ultimate incidence is highly unequal.

Retail Sales Tax: From this analysis there is much to say in favour of retail sales tax. The tax is levied at one stage only and so the evil effects of the general sales tax are not present. A beginning can be made with a tax of low incidence to gain experience.[1] The administrative difficulty of differentiating purchase for resale from that for consumption can be surmounted by proper rules.

Administrative Machinery

The problems of an efficient administrative machinery will be difficult to solve in a country with small villages. Perhaps in actual operation the Sales Tax will become a city tax as is the case in France. In such a case, towns or villages below 5,000 may be exempted. In other areas it would be advisable to classify the tax-payers into small vendors, petty shop-keepers and big dealers and stores. It will be a wastage to try to assess the small vendors on the basis of their sales. A system of *ad valorem* license duty on the basis of sales during the previous year or of an estimated value may be introduced. This method was adopted in assessing the retailers under the Bombay (District) Tobacco Act. A schedule of license duty was prescribed applicable to the value of sales. In France a system of lump-sum payment for vendors having sales below Fr. 48,000 per annum has been quite successful. It may be pointed out that this is also a sort of tax, although in a dis-

[1] The Punjab Resources and Retrenchment Committee has recommended a retail sales tax at a flat rate, p. 230.

guised form. For other classes of dealers a system of licensing with a nominal flat duty or registration fee should be adopted. The time and method of returns will have to be prescribed.

It will be difficult to estimate the yield of the tax for any Province. The yield will depend on the base, the rate, the number of exemptions, and the efficiency of administrative machinery. It can, however, be said that the tax has undoubtedly great possibilities. A small percentage, say, of 1 per cent. rising up to 10 per cent. on luxury articles will not be a hardship in the case of most of the consumers. The tax should be levied at the last stage, with a view to avoid complications, and the exemptions should be kept to the minimum.

In the States of the U.S.A. the proceeds of the tax have been earmarked for definite services such as unemployment relief, education, etc. Similar disposition was made under the Bombay Entertainment Duty Act in favour of primary education. It may be suggested that the same system may be adopted if Sales Taxes are imposed by the Provinces.

Experience of the Past

So far we have pointed out the general considerations that will arise in any Province that attempts the imposition of the Sales Tax. The exact nature of these considerations and their solution will vary according to the type selected, the method adopted and the circumstances of the Province concerned. Most of these things will have to be subject to modifications in the light of experience. In connection with the new taxes affecting a large number of people in their daily transactions, actual experience of the working of the tax will be the best guide for the future. Whereas we cannot claim to have such experience on a large scale, we have some sales taxes in the country as mentioned before.

Need for Enquiry

In view of the changes proposed by some Provincial Governments in their tax systems, and the need for finding

more sources of revenue in the near future, as well as in view of the acceptance of Sales Tax as one of the important forms of new taxation, it would be better if the incidence of taxation on different classes of people of the existing taxes and the new taxes is properly studied, and the entire tax system overhauled with a view to see that the burden is distributed more equitably. An urgent necessity for a comprehensive inquiry has thus arisen, if the tax-payers are to feel satisfied regarding the nature of the burdens that they are called upon to shoulder.

SALES TAX IN THE TAX STRUCTURE OF SOME COUNTRIES

Country.	Taxable transactions.	Ordinary rate tax per cent.	Luxury tax p. c.	Imports.	Exemptions (other than exports).	Sales tax revenue.			
						Year ending.	Sales tax revenue (in millions).	Total national revenue (in millions).	Sales tax as per cent of national revenue.
Australia ...	Manufacturers' sales	4	Same	Same	Agricultural food	1934-35	£. 8.5	59	14.6
Canada ...	,, ,,	8	,,	,,	,,	,,	$. 112.2	304	36.9
Belgium ...	Transactions in goods except at retail	2.5	6	,,	Sales & prime necessities	1935	Fr. 2244	8912	25
France ...	Total business receipts	2	3-16	,,	Agriculture and professions	,,	Fr. 5843	33272	17.6
Germany ...	Total business transactions	2-2.25	Same	Exempt	Few foods	1933-34	Rm. 1061	5109	20.8
Italy ...	Transactions in goods for business use	3	,,	Same	Sales of essential foods	1934-35	Liras 1114	16230	6.9
Russia ...	Gross receipts	1.6 to 17.5	,,	,,	Not available	,,	Roubles 52025	60050	86.6
Turkey ...	Manufacturers' sales	6	,,	,,	,,	,,	£. 16	153	10.5
California ... (U. S. A.)	Retail	2	,,	Exempt	None	1935-36	$. 73	326	21.7
Illinois ... (U. S. A.)	,,	2	,,	,,	,,	,,	$. 64	434	15
Indiana ... (U. S. A.)	Gross income	1/4 to 1	,,	,,	,,	,,	$. 16	155	13

APPENDIX II

STATISTICAL TABLES

(All figures in lakhs of rupees)

Table

I.	Increase in spending power of the Provinces under the financial settlement, 1937.
II.	Growth of Provincial Expenditure.
III.	Expenditure on Social Services.
IV.	Growth of Expenditure on Civil Works.
V.	Growth of Provincial Revenue.
VI.	Growth of Land Revenue.
VII.	Decline in Excise Revenue.
VIII.	Decline in Stamp Revenue.
IX.	Net Forest Receipts.
X.	Net Registration Receipts.
XI.	Receipts from New Sources of Revenue.
XII.	Interest Charges on Provincial Debt.

TABLE I
INCREASE IN THE SPENDING POWER OF THE PROVINCES

Province.	Subventions.	Average annual receipt of $62\frac{1}{2}$% Jute export duty for 1937–40.	Benefit from the consolidation or cancellation of debt.	Average annual receipt from 50% share of income-tax 1937–40.	Increased spending power at the cost of Government of India.	Relief from the Separation of Sind & Orissa.	Total Increase in spending power.
Madras ...	—	—	26	22.5	48.5	20	68.5
Bombay ...	—	—	14	30	44	90	134
Bengal ...	—	233	33	30	296	—	296
U. P. ...	25	—	13	22.5	60.5	—	60.5
Punjab ...	—	—	2	12	14	—	14
Bihar ...	—	14	22	15	51	8	59
C. P. ...	—	—	21	7.5	28.5	—	28.5
Assam ...	30	11.5	16	3	60.5	—	60.5
N. W. F. P.	100	—	12	1.5	113.5	—	113.5
Sind ...	105	—	1	3	109	—	109
Orissa ...	43	1.5	10	3	57.5	—	57.5
Total ...	303	260	170	150	883	118	—

TABLE II—PROVINCIAL EXPENDITURE

Province.		Expenditure 1936-37	Expenditure 1939-40	Increase over 1936-37	Percentage increase over 1936-37
Madras	..	15,77	16,41	64	4.06
Bombay	..	11,99	13,43	1,44	12.01
Bengal	..	11,74	14,65	2,91	24.89
U. P.	..	12,29	13,69	1,40	11.37
Punjab	..	10,84	11,96	1,12	10.33
Bihar	..	4,76	5,38	62	13.02
C. P.	..	4,81	4,83	2	.41
Assam	..	2,92	3,02	10	3.4
N. W. F. P.	..	1,80	1,86	6	3.3
Sind	..	3,60	3,76	16	4.4
Orissa	..	1,56	2,03	47	30
Total	..	82,08	91,02	8,94	10.9

TABLE III.—EXPENDITURE ON SOCIAL SERVICES

Province		Education 1936—37 A/Cs.	Education 1939—40 B.E.	Medical Relief 1936—37 A/Cs.	Medical Relief 1939—40 B.E.	Public health 1936—37 A/Cs.	Public health 1939—40 B.E.	Agriculture 1936—37 A/Cs.	Agriculture 1939—40 B.E.	Veterinary 1936—37 A/Cs.	Veterinary 1939—40 B.E.	Co-operation 1936—37 A/Cs.	Co-operation 1939—40 B.E.	Industries 1936—37 A/Cs.	Industries 1939—40 B.E.	Total 1936—37	Total 1939—40	Incrase over 1936—37
Madras	...	256	265	93	97	24	29	22	21	10	13	12	14	23	26	440	465	25
Bombay	...	160	210	42	48	22	31	14	13	4	4	6	53	6	13	254	373	118
Bengal	...	132	168	49	59	34	49	27	17	—	6	—	36	14	21	256	356	100
U. P.	...	206	215	34	37	22	24	27	80	4	5	5	7	15	29	313	397	84
Punjab	...	157	165	44	55	11	24	55	40	—	19	—	19	14	21	281	343	62
Bihar	...	69	78	21	26	10	14	18	11	—	4	—	5	9	11	127	149	22
C. P.	...	53	57	15	17	4	6	9	11	5	5	3	3	3	3	92	102	10
Assam	...	35	36	14	14	7	9	5	6	1	2	1	1	2	3	65	71	6
N.W.F.P.	...	21	24	7	7	1	2	5	3	—	2	—	1	—	2	34	41	7
Sind	...	28	31	7	8	2	3	6	9	1	1	1	1	—	2	45	55	10
Orissa	...	25	27	8	9	2	3	3	2	—	1	—	2	1	2	39	46	7
Total	...	1142	1276	334	377	139	194	191	213	25	63	28	142	87	133	1946	2377	451

TABLE IV.—EXPENDITURE ON CIVIL WORKS

Province	Expenditure 1936-37	Expenditure 1939-40	Increase or decrease over 1936-37.
Madras	1,24	1,37	13
Bombay	1,07	1,23	16
Bengal	98	1,59	61
U. P.	69	63	—6
Punjab	1,00	1,12	12
Bihar	43	46	3
C. P.	59	54	—5
Assam	61	46	—15
N. W. F. P.	34	35	1
Sind	12	43	31
Orissa	15	30	15
Total	7,22	8,48	126

TABLE V.—GROWTH OF PROVINCIAL REVENUE

Province	Revenue 1936-37 Accounts	Revenue 1939-40 B.E.	Increase or decrease over 1936-37	Percentage increase or decrease over 1936-37.
Madras	15,58	16,23	65	4.1
Bombay	12,40	13,14	74	6
Bengal	12,14	13,78	1,64	13.6
U. P.	11,92	13,31	1,39	11.5
Punjab	11,27	12,02	75	6.4
Bihar	4,58	5,38	80	17.4
C. P.	4,71	4,85	14	3
Assam	2,53	2,84	31	12
N. W. F. P.	1,75	1,81	6	3.4
Sind	4,00	3,83	—17	—4.25
Orissa	1,70	1,85	15	8.8
Total	82,58	89,04	6,46	7.87

TABLE VI.—LAND REVENUE

Province			Revenue 1936-37 Accounts	Revenue 1939-40 B.E.	Increase or decrease over 1936-37
Madras	..	..	4,76	5,00	24
Bombay	..	..	3,44	3,39	—5
Bengal	..	..	3,54	3,94	40
U.P.	..	..	5,65	6,05	40
Punjab	..	..	2,97	2,77	—20
Bihar	..	..	1,36	1,32	—4
C. P.	..	..	2,54	2,42	—12
Assam	..	..	1,30	1,33	3
N. W. F. P.	..	..	22	20	—2
Sind	..	..	50	49	—1
Orissa	..	..	41	31	—10
Total	..	..	26,69	27,22	53

TABLE VII.—EXCISE REVENUE

Province	Revenue 1936-37 Accounts	Revenue 1939-40 B. E.	Loss due to policy of Prohibition	Increase otherwise than for that policy.	Net increase or decrease over 1936-37	Excise Revenue in 1939-40 as percentage to total revenue
Madras	3,96	3,55	-65	24	-41	22
Bombay	3,25	1,77	-150	2	-148	13.4
Bengal	1,36	1,57	—	21	21	11.4
U. P.	1,53	1,16	-40	3	-37	8.7
Punjab	1,04	1,11	—	7	7	9.2
Bihar	1,16	1,03	-13	--	-13	20
C. P.	64	58	-8	2	-6	8.7
Assam	36	31	-5	—	-5	11
N.W.F.P.	9	9	—	—	--	4.8
Sind	35	35	—	—	--	9
Orissa	33	23	-10	--	-10	12.5
Total	14,07	11,75	-291	59	-232	13.2

TABLE VIII.—STAMP REVENUE

Province	Revenue 1936-37 Accounts	Revenue 1939-40 B.E.	Increase or decrease over 1936-37
Madras	1,95	1,67	—28
Bombay	1,47	1,44	—3
Bengal	3,02	2,56	—46
U. P.	1,63	1,44	—19
Punjab	90	86	—4
Bihar	97	1,05	8
C. P.	50	44	—6
Assam	18	19	1
N. W. F. P.	8	8	—
Sind	19	17	—2
Orissa	17	18	1
Total	11,06	10,08	—98

TABLE IX—FOREST RECEIPTS

Province	1936-37 Accounts			1939-40 B.E.			Net Increase or decrease over 1939-40
	Revenue	Expend.	Net.	Revenue	Expend.	Net.	
Madras ..	48	41	7	45	40	5	— 2
Bombay ..	48	29	19	42	37	5	—14
Bengal ..	18	15	3	22	18	4	1
U.P. ..	44	29	15	50	30	20	5
Punjab ..	22	20	2	24	20	4	2
Bihar ..	5	4	1	7	6	1	—
C.P. ..	48	38	10	49	35	14	4
Assam ..	17	12	5	17	12	5	—
N.W.F.P. ..	4	3	1	5	4	1	—
Sind ..	7	4	3	7	4	3	—
Orissa ..	4	4	—	6	6	—	—
Total ..	2,65	1,99	66	2,74	2,12	62	— 4

TABLE X.—REGISTRATION RECEIPTS

Province	Revenue	Expenditure	Net Receipt
	(1939-40 B.E.)		
Madras	31.7	29.6	2.1
Bombay	14.5	5.5	9
Bengal	22	23	—1
U. P.	9.5	4.6	4.9
Punjab	9.8	.7	9.1
Bihar	12.4	5.9	6.5
C. P.	6.2	2	4.2
Assam	1.7	1.4	.3
N. W. F. P.	.7	.1	.6
Sind	2	.9	1.1
Orissa	2.3	1.5	.8
Total	112.8	75.2	37.6

TABLE XI.—NEW SOURCES OF REVENUE

Province.	1936-37—Accounts					1939-40—Budget Estimates									Increase over 1936-37
	Cus-toms.	M.V.T. Acts	Amuse-ments	Others	Total	Cus-toms	Income tax (Including taxes on Agricul-tural in-comes).	M.V.T. Acts	Amuse-ments	Sales tax	Employ-ment	Pro-perty tax	Others	Total	
Madras ...	-	50	1	-	51	-	24	82	2	32	-	-	1	141	90
Bombay ...	-	41	20	29	90	-	32	43	22	76	-	127	5	305	215
Bengal ...	190	21	17	20	248	230	32	21	17	20	12	-	-	332	84
U. P. ...	-	-	-	-	-	-	26	11	5	8	30	-	40	120	120
Punjab ...	-	7	-	-	7	-	13	8	2	8	-	-	-	31	24
Bihar ...	11	-	-	-	11	14	36	-	1	a	-	-	12	63	52
C. P. ...	-	4	-	-	4	-	9	5	-	7	2	-	-	23	19
Assam ...	10	1	-	3	14	12	28	3	a	a	-	-	-	43	29
N.W.F.P...	-	1	-	-	1	-	2	2	1	a	-	-	-	5	4
Sind ...	-	2	1	2	5	-	3	2	1	2	-	-	-	8	3
Orissa ...	1	1	-	-	2	1	3	1	-	-	-	-	-	5	3
Total ...	212	128	39	54	433	257	208	178	51	153	44	127	58	1076	643

(a) figures not avilable.

TABLE XII.—INTEREST CHARGES OF PROVINCES

Province.	Total interest on Public Debt of the Provincial Governments.	Interest charges during 1936-37 Accounts. Deduct :- Transfers to Commercial Depts. and others. Irrigation	Hydro Electric Schemes	Others	Total	Balance being interest on debt of Pro. Govts.	Total interest on Public Debt of Provincial Govts.	Interest charges during 1939-40: Budget Estimates. Deduct :- Transfers to Commercial Depts. and others. Irrigation	Hydro Electric Schemes	Others	Total	Balance being interest on debt of Provincial Govts.	Increase or decrease in interest charges (Difference in cols. 1 & 7)	Increase or decrease in net interest charges (Difference in columns 6 & 2)
	1	2	3	4	5	6	7	8	9	10	11	12	13	14
Madras ...	65	78	11	4	93	—28	66	88	23	1	112	—46	1	—18
Bombay ...	191	42	...	5	47	144	163	42	...	4	46	117	—28	—27
Bengal ...	39	22	...	1	23	16	20	...	...	1	1	19	—19	3
U. P. ...	139	107	...	3	110	29	141	112	...	3	115	26	2	—3
Punjab ...	139	127	33	6	166	—27	133	143	28	5	176	—43	—6	—16
Bihar ...	18	11	...	1	12	6	6	...	...	...	...	6	—12	...
C. P. ...	34	27	...	6	33	1	25	...	...	5	5	20	—9	19
Assam ...	8	...	...	2	2	6	6	...	...	1	1	5	—2	1
N. W. F. P...	12	11	...	...	12	...	3	...	2	1	3	...	—9	...
Sind ...	139	134	...	...	134	5	130	129	...	...	129	1	9	4
Orissa ...	10	11	...	...	11	—1	1	...	...	...	...	1	—9	2
Total ...	794	570	45	28	643	151	694	514	53	21	588	106	—100	—45

APPENDIX III

REVIEW OF FINANCIAL ARRANGEMENTS FOR 1940-41

Status Quo Budgets

The budgets of most of the Provinces for the year 1940-41 are influenced by the present political situation in the country. After the resignation of the Congress Ministries in November 1939, efforts were made to see whether the Governments in the eight Provinces concerned could be entrusted to alternative parties. In Assam, an alternative government has been formed ; in the remaining seven Provinces, such an alternative was not possible, and the Governors had to assume the responsibility of carrying on the administration. They appointed Advisers from among Senior members of the Civil Service, and the Legislatures have been suspended for all practical purposes. The non-Congress Provinces, Punjab, Bengal, and Sind continue to function under the Act of 1935. In Sind, however, local political difficulties presented themselves with the consequence that the Government was unstable for a time, and a new Government has been recently formed.

It is necessary to appreciate this background in order to understand the budget proposals for the year 1940-41. The Governors in the seven Provinces in which they have assumed power have been trying to carry on the administration without any big changes in policy. The policy which was initiated by the Congress Governments is being carried out as far as possible ; further impetus to Congress policy is not being given ; and at the same time new departures in policy are not attempted. This attitude is reflected in the budget estimates for 1940-41 for these Provinces, which show no changes of importance, and are merely intended to carry on the *status quo*.

The Governments of the Punjab, Bengal, Assam and Sind could have initiated new policies if they so desired, but we find that in these Provinces also, no important change is to

be found in the Budget Estimates. The popular ministries in these Provinces are obviously consolidating their position instead of embarking on new schemes.

Change in the Niemeyer Award

One important change affecting the finances of all Provinces has however taken place apparently as a result of the War, but really in the interest of the Centre. The increase in the expenditure of the Central Government on account of the War, and the imposition of new taxation by that Government gave an excuse to the Centre to get the Niemeyer Award changed in its favour, at a time when the Provinces which were going to be affected adversely thereby were not likely to protest with any effect, because of the prevailing political deadlock. In order to understand the full significance of the amendment of the Order-in-Council embodying the Niemeyer Award, we shall first briefly state the position under the Award and then discuss the change.

The Niemeyer Award provided that the Provinces should receive 50 per cent. of the share of income tax other than corporation tax and the tax collected from federal emoluments and centrally administered areas. But the Federation was authorised to retain the whole or a part of the Provincial share for a period of five years, such that the federal share together with the retained Provincial share and any contribution to the Central revenues from the Railways amounted to Rs. 13 crores, the estimated amount required to balance the Central Budget. Any excess over this figure not exceeding the 50 per cent. provincial share was to be distributed on the lines indicated in the same Order among the Provinces. In the next period of five years, the retained portion of 1941-42, if any, was to be reduced by $\frac{1}{6}$th in each of the succeeding years so that the Provinces would become entitled to the full share in the eleventh year of the Autonomy.

By an amendment of the Order which comes into force retrospectively from 1st April 1939, it is now provided that

the contribution from the Railways to the Central Revenues will, henceforward, be altogether excluded from the calculation of the financial settlement between the Centre and the Provinces. Besides, out of the Provincial share of income tax as defined above and assigned to the Provinces, the Centre will retain Rs. 4½ crores, the average sum retained during the period 1937-39. This formula will remain in operation from 1939-40 to 1941-42, after which the retained portion will be reduced by $\frac{1}{6}$th each year as provided before.

The full implications of this amendment are not apparent at first sight and require a careful examination. The following figures will clearly bring out the change in the Provincial receipt of income tax on the old and the new basis. The figures do not include the portion of the Excess Profits Duty not classed as Corporation Tax and therefore to be shared with the Provinces, as no estimates are available for the same.

	1939-40 R.E.	1940-41 B.E.
	(In lakhs of Rs.)	
Divisible Pool of Income Tax	1,376	1,500
Railway Contribution	361	531
Total ..	1,737	2,031
Retained under Niemeyer Award	1,300	1,300
Available for distribution under old order.	437	731
Amount distributed under new formula	238	300
Loss to the Provinces ..	199	431

It has been explained that the result of the amendment will be that the Provinces will get the benefit from the improvement of Income Tax revenue as a result of the War including the divisible portion of the Excess Profits Duty. The above figures show the unreality of the benefit. This is not all. The amount retained by the Centre during 1941-42 regulates the amount to be retained during the next five years. During 1940-41, the Provincial share of Income Tax is Rs. 7·5 crores

of which Rs. 7·31 crores would have been available for distribution among the Provinces according to the old formula. This was so because the Railway Contribution having increased, the Centre required only Rs. 19 lakhs from the Provincial share to make up its total requirement of Rs. 13 crores. If this system had been followed, the Centre would no longer be in need of any part of the Provincial share in 1941-42, and the Provinces would have obtained their full 50 per cent. share of Income Tax from that year. But under the revised Order, the retained portion in 1941-42 is Rs. 4½ crores. On this basis under the new arrangement the Centre will be entitled to retain the following amounts during the next five years :—

	Lakhs of Rupees.
1942–43	375
1943–44	300
1944–45	225
1945–46	150
1946–47	75

Sir Jeremy Raisman justified this alteration in the Niemeyer formula because of the change in the financial situation brought about by the War. He argued that " the Centre has had to shoulder the entire burden of the increased expenditure on Defence, an appreciable amount of extra civil expenditure arising from the war, while there has been very little corresponding increase in provincial expenditure ; at the same time the Centre's chief source of revenues, namely, customs duties, has been adversely affected ". Whatever may be the argument for the amendment, it is obvious that the Provinces do not benefit in any way but are losers in the bargain. It has been already made clear that the Provinces have embarked on a definite change of policy in Expenditure, with the inauguration of Autonomy. The Congress Governments sacrificed many sources of revenue and imposed fresh taxation calculated to build the national economy. The Provinces have made

repeated demands for the immediate grant of their full share of Income Tax in order to enable them to fulfil their programme of national reconstruction. In this circumstance this encroachment on Provincial Revenues at the present juncture cannot be justified either on financial or political grounds.

This arrangement reflects the outlook of the Central Government that irrespective of provincial requirements what it considers to be necessary for the security of the Centre should be guaranteed first at all costs. This mentality of the Government of India was revealed during the recent budget discussions in the Central Legislature when Sir Jeremy Raisman observed that : "we were faced with a situation in which it was by no means impossible that on the Niemeyer formula one half of the divisible income-tax would fall to be distributed to the Provinces from the third or fourth year of the ten-year period" and that "the whole scheme which the framers of the Constitution had drawn up in order to enable the Centre to adjust itself to the devolution of income-tax was to be swept away in the course of a few months."

The fact that the Provinces have an equal interest in the financial settlement and that any one-sided decision should not have been made affecting their finance adversely is borne out by the report of Sir Otto Niemeyer. He did contemplate the possibility of the time when the Provinces might get their full share being shorter than ten years, though he emphasised that it should not be longer than that period.[1]

[1] Sir Otto Niemeyer said : "It is less easy to prescribe within this first period how much in fact can be surrendered. Obviously conjectures fixing how specific dates in this period might, in the present state of economic flux in the world, in fact prove substantially wide of the mark : and if such a conjecture had to be made so soon in terms of such and such a year it might perhaps more easily err on the side of caution than on the side of temerity to the disadvantage of the Provinces. To avoid these inconveniences it will be preferable to base the amounts to be withheld not so much on specific but on conjectural dates, but on the realisation of certain concrete facts". He further said that " it is in my view very desirable to give both the Central Government and the Provinces an interest in securing

Provincial Budgets for 1940—41

We shall now briefly summarise the budget proposals of the different Provinces. In doing so, we shall not go into details because of the fact that no other important change has been made in the finances of the Provinces due to reasons explained above.

(1) Madras

The revised estimates for 1939-40 show revenue (inclusive of the 1938-39 surplus of Rs. 3·75 lakhs) at Rs. 16·41 crores while the expenditure also stands at the same figure. This result has been due to new taxation which yielded Rs. 55 lakhs and a reduction in expenditure of Rs. 30 lakhs.

The budget estimates for 1940-41 are placed at Rs. 16·76 crores and expenditure at Rs. 16·75 crores. The budget provides for the continuation of the policy of the Congress ministry without any substantial modifications. The provision for Land Revenue remissions is on the same scale and on the same basis as in the previous year. Other grants are also on the same basis but the policy of Prohibition is not to be extended beyond the four districts in which it has been introduced, the loss in which is estimated at Rs. 56 lakhs which is fully covered by the new taxation measures. The taxation measures would have yielded Rs. 1 crore during 1940-41 but in that case there would have been an increase in the surplus by Rs. 31 lakhs. As the new taxes provide more than what

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these results (*viz.* expansion of income-tax and surplus of the railways) and a share in their advantages if and as soon as they are achieved." In connection with the second period of five years he said that "in the first year of the second quinquennium the amount retained should be five-sixths of the sum, if any, in the last year of the first period," and that "if by the favourable operation of these factors, the amount held back proved in fact to be substantially less than the whole Provincial share it is obvious that the task of the Centre in relinguishing it will *pro tanto* be lightened. Here again a long and a somewhat conjectural view of the future has to be taken. In my opinion however it should prove safe to fix the second prescribed period at five years so that *within about ten years* from the commencement of Provincial Autonomy the Provinces may hope to be enjoying the full share in this revenue head."

is required, the Government has decided to reduce the rate of the turnover tax from ½ per cent. to ¼ per cent. and the slab rate to Rs. 4 when the turnover exceeds Rs. 10,000 but is less than Rs. 20,000[1] so as to reduce the yield by Rs. 31 lakhs.

Although the budget of the Province marks no advance, the fact that the Government has been able to reduce taxation proves the financial soundness of the Province.

(2) Bombay

The revised estimates for 1939-40 show revenue receipts of Rs. 13.02 crores, expenditure of Rs. 12.82 crores and a surplus of Rs. 20 lakhs. The main variations are an increase under Income Tax and Excise due to certain adjustments, and decreases under Stamps owing to the contemplated establishment of debt conciliation boards, and 'Other Taxes and Duties' consequent upon the suspension of the Sales Tax on cloth. The net result is that the revenue is up by Rs. 12 lakhs.

The expenditure on rural development schemes for which a sum of Rs. 45 lakhs was provided will be considerably less as it took some time to formulate the schemes. Owing to other variations the net decrease in expenditure is Rs. 11 lakhs. In view of this it has been decided by the Governor to transfer a sum of Rs. 25 lakhs to the Special Development Fund with the result that the year will show a nominal deficit of Rs. 5 lakhs.

The budget estimates for 1940-41 show revenue receipts of Rs. 12·83 crores and expenditure of Rs. 12·82 crores. These estimates provide for the continuation during the next year without substantial modification of the various schemes in force during the year 1939-40. It is however difficult to understand why the provision for Rural Development Schemes amounts to Rs. 14 lakhs only against Rs. 45 lakhs in the previous year. The scheme of Prohibition has also been continued and in order to meet the expenditure the Bombay Finance Act

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[1] Vide Page 115.

providing for the levy of the Urban Immovable Property Tax, the Electricity Duty, etc. has been extended for a year.

Since the inauguration of Provincial Autonomy the most striking feature of the financial policy of the Province is the introduction of Prohibition with a loss of Rs. 166 lakhs or 50 per cent. of the pre-Autonomy Excise Revenue. This has almost been covered by additional taxation as follows :

	Rs. (In lakhs)
Urban Immovable Property Tax ..	110
Sales Tax	40
Others	23
Total	163

There has also been an increase of expenditure under the nation building departments. This has been financed from the share of Income Tax and the relief due to the separation of Sind.

There has been no increase of the debt of the Province. The funded debt has been reduced with a corresponding increase in the unfunded debt. The capital expenditure aggregating to Rs. 80 lakhs during the four years beginning with 1937 has been met from balances.

Thus the financial position of the Province is sound. The creation of the Special Development Fund ensures the continuity of the programme of rural reconstruction. A sum of Rs. 19 lakhs from the Fund is provided for 1939-40 and Rs. 27 lakhs in 1940-41 leaving a balance of Rs. 29 lakhs at the end of 1941. But the problem of financing the rest of the programme will baffle the popular ministers when they resume responsibility.

(3) Bengal

The Government of Bengal has a deficit budget for 1940-41 for the second year in succession. The opulence that marked the opening of Provincial Autonomy disappeared at the end of the second year. The year 1937-38 closed with a surplus of Rs. 1·18 crores against the balanced accounts for 1938-39.

Thereafter there have been continuous deficits. The revised estimates for 1939-40 show a deficit of Rs. 14 lakhs revenue being Rs. 14·02 crores and expenditure of Rs. 14·16 crores against a budgeted deficit of Rs. 87 lakhs. This was the combined result of a net increase in revenue by Rs. 25 lakhs mainly under the 'New Sources' and a reduction in expenditure by Rs. 48 lakhs mainly due to the fact that all the schemes of expenditure could not be carried through.

The revenue in the budget estimates for 1940-41 is placed at Rs. 13·97 crores or Rs. 5 lakhs lower than the revised estimates for the previous year owing to a decrease under land revenue and the extraordinary receipts, although the 'New Sources' show an increase. There is also a net increase of Rs. 38 lakhs, or Rs. 14·54 crores of expenditure. The increase would have been higher but for the fact of the curtailment of leave outside India involving smaller expenditure on leave arrangements of officers. The increase in the expenditure is due to the incorporation of the schemes of the previous year such as debt conciliation machinery, public health, etc. The final result of all this is a deficit of Rs. 57 lakhs.

In view of this financial stringency, it was not possible to enter upon new schemes. The Government is surveying possible sources of new revenues permitted to the Provincial Governments under the Government of India Act and in course of time the Government hope to propose new taxation measures.

In spite of the very favourable terms having been granted to Bengal in the financial settlement of 1937, it is once again in a chronic state of deficit. The finances of Bengal have close connection with its land revenue system, an early reform of which is considered desirable by all. The report of the Land Revenue Committee appointed by the Bengal Government is not yet published. So far as forecasts of the report published in the press are concerned, we may take it that Bengal will be faced with acute controversies on the proposal to purchase the

zamindaris by the state. We do not propose to discuss the problem here because of want of authoritative information.

(4) *The U. P.*

The revised estimates for 1939-40 show revenue receipts of Rs. 13·32 crores, expenditure charged to revenue of Rs. 13·81 crores and a deficit of Rs. 49 lakhs. This is Rs. 11 lakhs higher than the anticipated deficit last year. The Employment Tax bill estimated to yield Rs. 30 lakhs has been suspended and so the deficit could not be covered.

The estimates for 1940-41 show the revenue receipts at Rs. 13·58 crores and expenditure also at the same figure thus presenting a balanced budget. The budget provides for the continuation of the policy of the late ministry specially Prohibition without any further extension. The budget includes Rs. 9 lakhs for new items and the services for a loan of Rs. 1·25 crores.

(5) *The Punjab*

The budgets of the Punjab Government are overshadowed by the famine conditions for the last three years. The revised estimates for 1939-40 on the income side are almost constant. The increase under 'New Sources of Revenue' is counterbalanced by a fall under Excise and Stamps. The expenditure is placed higher by Rs. 22 lakhs mainly on account of famine relief with the result that the year is expected to close with a deficit of Rs. 49 lakhs or Rs. 8 lakhs if extraordinary receipts are included.

The revenue for the budget estimates for 1940-41 is placed at Rs. 11·74 crores or Rs. 5 lakhs higher than the revised estimates for the previous year. The 'New Sources' show an increase of Rs. 3 lakhs. The expenditure is estimated at Rs. 12·02 crores inclusive of that on famine relief or Rs. 16 lakhs higher than the previous year. The main decrease is under famine relief from Rs. 72 lakhs for 1939-40 to Rs. 32 lakhs for 1940-41 or a decrease of Rs. 40 lakhs. The budget shows a deficit of Rs. 28 lakhs.

The extraordinary receipts from the sale of land are estimated at Rs. 50 lakhs without any corresponding expenditure. After utilising these receipts the deficit will be converted into a surplus of Rs. 22 lakhs. The famine of the magnitude and the nature that has occurred in the Punjab justifies the utilisation of the extraordinary receipts for expenditure and does not violate the principles of sound finance.

On the expenditure side the main variations are an increase in interest charges consequent upon a larger capital outlay. There is a slight increase under security services owing to the war measures. There is also an increase under social services mainly on schemes financed from the Special Development Fund.

The characteristic feature of the financial policy under Autonomy has been an increase in expenditure on account of expanding irrigation projects and on social services. In spite of famine conditions, the expenditure on social services strengthening the foundations of economic life has increased by Rs. 60 lakhs since 1937. This is partly covered by rigid economy and retrenchment and partly by new taxation and receipts from Income Tax.

(6) Bihar

The revised estimates for 1939-40 show revenue of Rs. 5·3 crores or Rs. 1 lakh higher than the original. There is a heavy decline under Agricultural Income Tax counterbalanced by larger receipts from the Central Government on account of Customs and Income-Tax. The expenditure is placed at Rs. 5·5 crores or Rs. 12 lakhs higher. The increase is mainly on account of expenditure in connection with rent reduction operations.

The revenue for 1940-41 is estimated at Rs. 5·5 crores and expenditure at Rs. 5·46 crores, showing a small surplus of Rs. 4 lakhs. The estimated increase in revenue is mainly due to the taxes on Agricultural Income and Sales Tax. The budget provides for the continuation without curtailment of the

essential activities of the nation building departments or of the degree of Prohibition already introduced. An amount of Rs. 2 lakhs has been provided for the continuation of mass literacy work, Rs. 4·23 lakhs for cane development schemes, and Rs. 2 lakhs for rural development, while several schemes are still under consideration.

(7) *The C. P.*

The revised estimates for 1939-40 show revenue receipts at Rs. 4·87 crores, expenditure at Rs. 4·84 crores and a surplus of Rs. 3 lakhs which is higher by Rs. 2 lakhs than the earlier estimates. The main heads contributing to this situation is an increase under Income Tax and Land Revenue aggregating to Rs. 9 lakhs partly counterbalanced by a fall under other heads. On the expenditure side there is a decrease under civil administration partly counterbalanced by an increase under interest charges.

The estimated revenue receipts for 1940-41 are placed at Rs. 4·95 crores, the increase being mainly under Stamps, Forests and Civil Works. Excise provides for a loss of Rs. 3 lakhs on account of the extension of Prohibition from January last. The expenditure is placed at Rs. 4·95 crores inclusive of the proposed appropriation of Rs. 8·5 lakhs to the newly created Revenue Reserve Fund. The other items include provision for Prohibition propaganda and the establishment of Vidya Mandirs in the Province.

The characteristic of the C. P. finances for the last decade have been chronic deficits consequent upon the non-realisation of estimated land revenue due to various reasons. The previous arrears were taken into account at the time of subsequent budgeting with the consequence that the situation worsened from year to year. In order to avoid this it has been decided by the Government to take into account the standard land revenue at Rs. 2·2 crores for the purpose of budgeting, and whatever is collected above this figure will be credited to the Revenue Reserve Fund to be used towards meeting the deficits

in future due to short recoveries of land revenue. The proposal is welcome from many points of view. It marks an improvement in budgetary procedure and stabilises the finance of the Province.

(8) *Assam*

There is no fundamental change in the financial policy of the Assam Government. The taxation measures passed during the short Congress regime have begun to yield revenue. The Agricultural Income Tax will show a return of Rs. 35 lakhs during 1940-41 including Rs. 10 lakhs of arrears. There is an increase under Motor Vehicles Tax, as well as the Sales Tax although the sales taxation of luxury articles was postponed and has now been dropped. This is counterbalanced by a heavy decline of Rs. 13 lakhs under Land Revenue consequent upon the extension of remissions, and under Excise owing to the policy of Prohibition.

There is very little variation in the revised estimates for 1939-40. The revenue is placed at Rs. 281 lakhs or Rs. 3 lakhs less and the expenditure at Rs. 3 crores or Rs. 2 lakhs less.

The budget estimates for 1940-41 are placed at Rs. 324 lakhs or 43 lakhs more than the revised estimates because of the causes mentioned before. The expenditure is placed at Rs. 319 lakhs or an increase of Rs. 19 lakhs. There is an increase in the interest charges by Rs. 1 lakh, in social services by Rs. 3 lakhs and a large increase under Civil Works.

After many years of deficits, the year 1940-41 shows a nominal surplus of Rs. 5 lakhs. Allowing for the arrears of collection of Rs. 10 lakhs under Agricultural Income Tax, the budget shows a real deficit of Rs. 5 lakhs. This is so even after receiving financial aid from the Centre to the extent of Rs. 50 lakhs and improving revenue to the extent of Rs. 35 lakhs by new taxation.

(9) *N.W.F.P.*

The revised estimates for 1939-40 show revenue of Rs. 185 lakhs and expenditure of Rs. 188 lakhs or a deficit of Rs. 3

lakhs. One important variation for the year was the provision of Rs. 1·69 lakhs for employment of special additional police in the southern districts for the prevention of raids. The revenue for 1940-41 is estimated at Rs. 186 lakhs, which is also the amount of expenditure thus resulting in a balanced budget.

(10) Orissa

The revised estimates of revenue for 1939-40 are Rs. 1·94 crores against expenditure of Rs. 1·96 crores, thus showing a deficit of Rs. 2 lakhs. The budget for 1940-41 shows a deficit of Rs. 5 lakhs. The total revenue is estimated at Rs. 195 lakhs and expenditure at Rs. 2 crores.

(11) Sind

The Sind budgets have been overshadowed by the problems of the Lloyd Barrage and its debt. The irrigation receipts have not begun to pay the interest charges on the outlay, the deficit being made good by receipts from the sale of land. It should be well realised that these receipts are of a non-recurring character and should have been utilised in payment of debt.

The debt amounting to Rs. 24·59 crores by the end of 1940 is to be consolidated from 1942-43 to be liquidated in 40 years. The rate of interest will be 4½ per cent. and the capital payment Rs. 75 lakhs for 15 years, Rs. 60 lakhs for the next 10 years and Rs. 50 lakhs thereafter. The gravity of the situation will be well realised from the fact that the debt has been reduced by Rs. 50 lakhs only during the four years of Autonomy.

The revised estimates for 1939-40 are placed at Rs. 4 crores or Rs. 17 lakhs more than the earlier estimates. The principal heads contributing to this increase are Income Tax, Entertainment Tax, Sales Tax and receipts from the sale of land. The expenditure is placed at Rs. 3·95 crores or an increase of Rs. 19 lakhs over the budget estimates. The main item is the capital payment in liquidation of debt. Thus the year is expected to close with a surplus of Rs. 6 lakhs. The budget estimates for 1940-41 place the revenue at Rs. 4 crores. There is a decrease

of Rs. 2 lakhs under Excise consequent upon the adoption of a policy of partial Prohibition counterbalanced by other increases. The expenditure is placed at Rs. 3·98 crores or Rs. 3 lakhs higher. The increase is mainly under Civil Works and security services partly counterbalanced by a smaller provision for reduction of debt. Thus the year is expected to close with a surplus of Rs. 2 lakhs.

Conclusion

Provincial Finance has come to assume static conditions. It had been the practice under the previous regime to finance the commitments from given sources of revenue without material change and to balance the budgets. The budgets for 1940-41 either under 'dictatorial' or popular regime marks no fundamental change in policy, for reasons which we have already discussed.

In 1937-38 the first year of Autonomy there was a surplus of revenue over expenditure of Rs. 2·73 crores in the Provinces. As compared with this the year 1940-41 shows a deficit of Rs. 28 lakhs taking all the Provinces together,[1] although there have been material additions by way of new taxation and the increase under Income Tax. As compared with the budget estimates for 1939-40, there is an increase under Income Tax by Rs. 1·5 crores and there is the additional yield from new taxation by about Rs. 1 5 crores during 1940-41. Even then the total increase in the revenue is only Rs. 1·7 crores. This leads us to the conclusion that the older taxes are drying up and the existing revenues are not adequate to meet the charges in full. Thus the prospect of Provincial Finance is not bright. With the rise in prices there is likelihood of increase in expenditure for which there is no provision. Besides the expanding social services require larger revenues. Thus the Provinces will have a gloomy future unless there is some radical change in the circumstances.

[1] We give below a table giving the revised estimates for 1939-40, and the budget estimates for 1940-41 of all the Provinces.

PROVINCIAL BUDGETS FOR 1940—41

(In lakhs of Rupees)

Province	1939-40 R. E.			1940-41 B. E.		
	Revenue	Expenditure	Surplus or Deficit	Revenue	Expenditure	Surplus or Deficit
Madras ..	1641	1641	—	1676	1675	+ 1
Bombay ..	1302	1307	— 5	1282	1282	—
Bengal ..	1403	1417	—14	1397	1454	—57
U.P. ..	1332	1381	—49	1358	1358	—
Punjab ..	1210	1218	— 8	1224	1202	+ 22
Bihar ..	546	550	— 4	550	546	+ 4
C.P. ..	487	484	+ 3	495	495	—
Assam ..	281	300	—19	324	319	+ 5
N.W.F.P. ..	185	188	— 3	186	186	—
Sind ..	401	395	+ 6	400	398	+ 2
Orissa ..	194	196	— 2	195	200	— 5
Total ..	8982	9077	—95	9087	9115	—28

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(The letter ' n ' after a figure denotes a footnote.)